3 April 2024
EM macro

CIS macro and credit

The path to normality

We continue to monitor macro and credit developments in our CIS-4 coverage space. In this report, we look at how Russia's neighbours are returning to business as usual following the double shock of the global pandemic and geopolitics of 2020-22. The common denominator would be a return to average growth rates, disinflation and addressing the imbalances on the FX market.

- **Armenia's** economic performance remains robust and continues to beat expectations. 2023 GDP growth was 8.7% and the monthly indicators are pointing at a strong start to 2024. Fiscal performance also seems under control, while CPI is in the negative since mid-2023, creating room for monetary easing. Our fears of dram depreciation also failed to materialise for now. Overall, we improve our key macro expectations for 2024, while keeping our reservations about the GDP growth structure, the effect of refugee inflow, and the weakening in the balance of payments as main watch factors. Meanwhile, the stop of processing of Russian-issued bank cards in Armenia starting 2Q24 may give a boost to more transparent banking services to immigrants.

- **Azerbaijan** has lagged its CIS peers in terms of economic performance, largely due to volatility in commodity extraction, but 2024 should bring some normalisation. Financially, the country remains exceptionally strong, with fiscal revenues beating expectations and the current account surplus remaining highly positive. Monetary policy has some scope for easing given the noticeable disinflationary trend. Meanwhile, the key issues remain the same – from ageing oil fields and a weak institutional framework to persisting foreign policy risks related to tensions with neighbouring Armenia.

- **Kazakhstan** had a successful 2023, showing solid GDP growth, better-than-expected fiscal performance, slowdown in the CPI, easing in the monetary policy, and a stronger-than-expected currency. We are confident that this year disinflation and the key rate cut cycle are likely to continue, but all the other positive trends will be put to a test. Economic activity is showing signs of slowdown, fiscal revenues are dependent on volatile non-tax items, while a widening in the current account deficit and government intention to limit the spending of sovereign oil fund may pose a challenge to the strength of the tenge.

- **Uzbekistan** macro dynamics have been largely in line with our initial expectations. Economic activity is showing stable growth, supported by relations with neighbours and apparently financed by the state. The 2.1ppt drop in unemployment to 6.8% during 2023 amid the growing labour force was the biggest positive news. Inflation, key rate, and the soum are also moving in line with expectations. At the same time, a decline in transparency of the fiscal data is a bit of a concern. The government's ability to proceed with tariff liberalisation for the households, and its effect of inflation and the fiscal performance will be a key watch factor for 2024.

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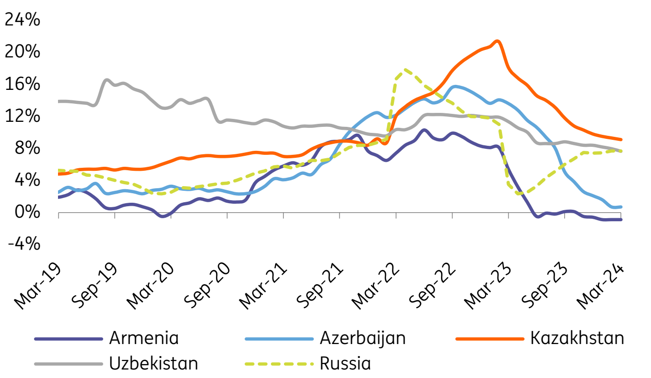
Selected macro indicators for 2022-24F

	Armenia			Azerbaijan			Kazakhstan			Uzbekistan		
	2022	2023	2024F	2022	2023	2024F	2022	2023	2024F	2022	2023	2024F
GDP												
Real GDP (%YoY)	12.6	8.7	5.8	4.7	1.1	2.5	3.2	5.1	4.5	5.7	6.0	5.5
Nominal GDP (US$bn)	18.4	22.4	22.1	78.8	72.4	75.3	225.5	261.4	292.5	81.2	90.9	97.6
GDP per capita (US$)	6572	8095	7910	7806	7126	7292	11477	13276	14336	2276	2475	2607
Fiscal balance												
Consolidated budget balance (% of GDP)	-2.2	-1.9	-2.5	6.0	8.2	5.3	-1.3	-0.5	-1.2	-3.9	-5.5	-4.5
Public debt (% of GDP)	49.2	48.1	50.6	17.3	18.8	19.5	24.4	22.8	22.7	34.9	37.7	39.1
Fiscal breakeven Brent (US$/bbl)	n/a	n/a	n/a	67	54	62	115	90	103	n/a	n/a	n/a
Balance of payments												
Current account (% of GDP)	0.8	-2.1	-3.8	29.8	11.5	10.0	3.1	-3.3	-3.9	-0.8	-8.6	-8.4
Trade balance (% of GDP)	-9.5	-10.1	-10.0	34.7	17.7	17.5	15.5	7.7	4.7	-13.8	-16.6	-16.6
Foreign debt (% of GDP)	78.2	65.9	67.1	19.0	20.0	19.3	71.2	55.0	50.2	62.6	62.5	61.3
Current account breakeven Brent (US$/bbl)	n/a	n/a	n/a	38	56	60	84	99	106	n/a	n/a	n/a
CPI, Interest & exchange rate												
CPI (year-end, %YoY)	8.3	-0.6	3.7	14.4	2.1	4.8	20.3	10.1	8.0	12.3	8.4	10.6
Central bank key rate (year-end, %)	10.75	9.25	7.50	8.25	8.00	7.00	16.75	15.75	12.50	15.00	14.00	14.00
Exchange rate vs USD (year-end)	394	405	423	1.70	1.70	1.70	463	455	470	11229	12346	12964

Source: National sources, CEIC, ING

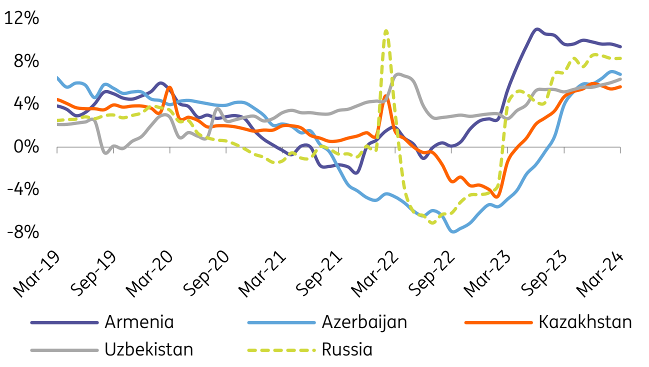
CIS cross-country overview charts

Fig 1 Inflation (% YoY)



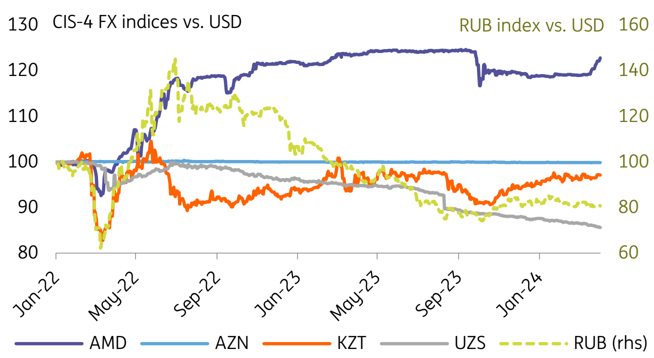
Source: National sources, CEIC

Fig 2 Real policy rates (%)



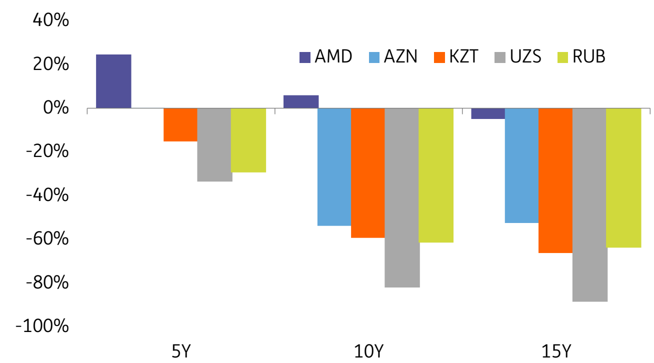
Source: National sources, CEIC, ING

Fig 3 CIS currencies vs USD, index, end-2021 = 100



Source: National sources, Refinitiv, CEIC, ING

Fig 4 Long-term performance of CIS currencies vs USD



Source: National sources, Refinitiv, CEIC, ING

Armenia

Economic overview

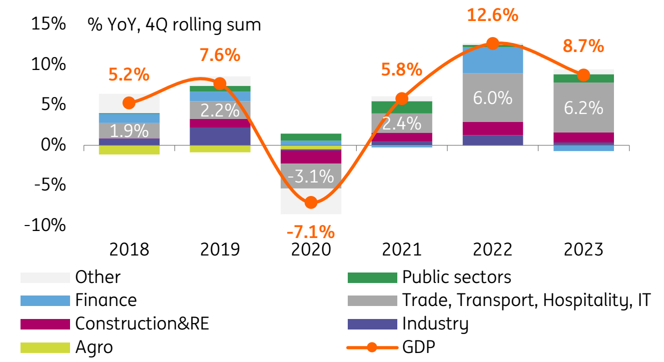
Armenia's economic performance remains robust and continues to beat expectations. 2023 GDP growth was 8.7% and the monthly indicators are pointing at a strong start to 2024. Fiscal performance also seems under control, while CPI is in the negative since mid-2023, creating room for monetary easing. Our fears of dram depreciation also failed to materialise for now. Overall, we improve our key macro expectations for 2024, while keeping our reservations about the GDP growth structure, the effect of refugee inflow, and the weakening in the balance of payments as main watch factors. Meanwhile, the stop of processing of Russian-issued bank cards in Armenia starting 2Q24 may give a boost to more transparent banking services to immigrants.

Economic activity. Armenian GDP posted an 8.7% increase in 2023 despite the high base of 2022 (12.6%), exceeding our 8.0% expectations on strong 7.8% growth in 4Q23. Moreover, the preliminary monthly activity data point at 20%+ growth in industrial production for the third month in a row in January 2024 amid elevated lending growth of 17% YoY in the corporate segment and 24% YoY in retail. This suggests that 2024 growth is likely to remain above the pre-2022 trend of close to 6%.

Meanwhile, there are couple of subtle signs of a change in the growth structure. First, in 2023, growth outside the immigration-driven and consumption-focused services (industry, finance, construction) weakened. Second, electricity output has been negative, at -9% YoY in the last three months, suggesting that growth is increasingly driven by the consumer-focused sectors. Without having a direct negative effect on growth in the near term, we see these indicators as watch factors for the longer run.

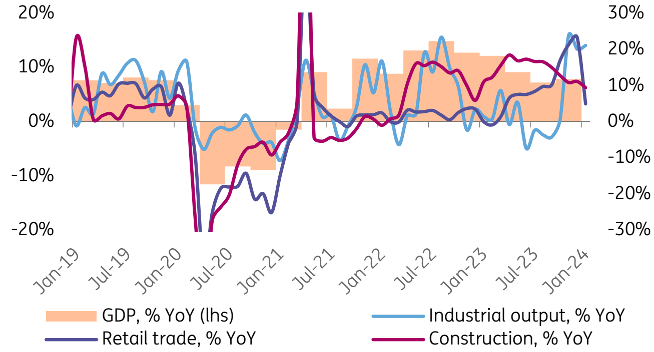
That said, the decision to cease processing the Russian-issued Mir bank cards may force the immigrants living in Armenia but working in Russia to more actively open accounts in Armenian banks, for which a proof of address (rent agreement) is required. While that may put some strain on the current financial ties with Russia it is unlikely to provoke an exodus out of Armenia. Potentially it may lead to more value added created in the financial, real estate, and construction sectors.

Fig 5 Armenia: GDP growth components



Source: National sources, CEIC, ING

Fig 6 Armenia: Key activity indicators

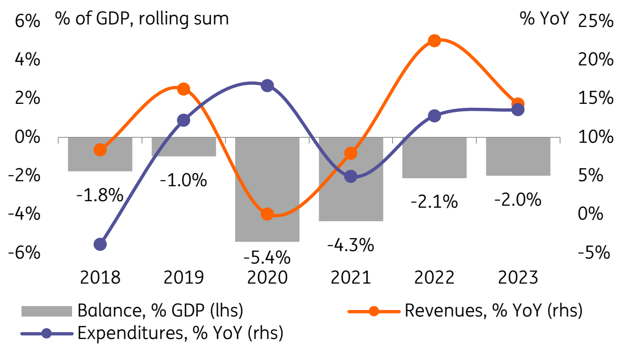


Source: National sources, CEIC, ING

Budget policy. Fiscal performance came in 0.5ppt GDP stronger than we expected, with the consolidated deficit narrowing from 2.2% in 2022 to 1.9% in 2023, contrary to the widening trend observed throughout most of last year. We attribute this performance mostly to higher-than-expected revenue collection thanks to strong economic activity.

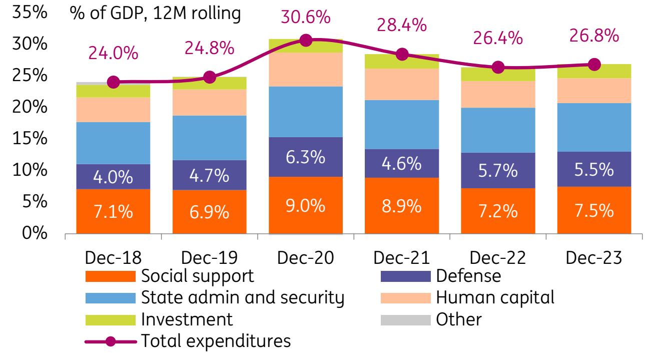
The expenditure side showed an increase by 0.4ppt GDP to 26.8% amid higher social and state spending – which was only to be expected amid the influx of refugees from Artsakh (Nagorno-Karabakh), but the military spending surprisingly did not increase, also playing a part in the narrower-than-expected deficit. Meanwhile, given the continued tensions with neighbouring Azerbaijan and persisting social issues we expect the fiscal deficit to continue tending to widen in the coming years, albeit without major concerns about the fiscal stability.

Fig 7 Armenia: Key budget parameters



Source: National sources, CEIC, ING

Fig 8 Armenia: Budget expenditure, 12M rolling basis

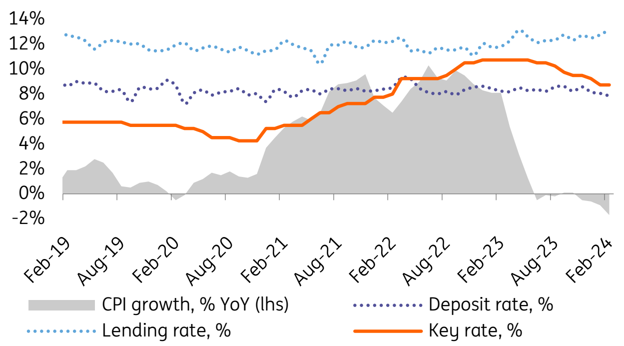


Source: National sources, CEIC, ING

Inflation and monetary policy. Armenia is an outlier in our coverage space in terms of CPI performance, posting a deepening deflation of 0.7% YoY in December 2023 and 1.7% YoY in February 2024, underperforming our and consensus price growth expectations despite stronger-than-expected economic growth. The Central Bank of Armenia (CBA) is mentioning dram appreciation and global disinflationary trends as the primary reasons, adding that growth in the domestic labour supply also contributed. We note that the official employment figures are showing just a 5.1% YoY increase in employees as of December 2023, which is more modest than 5.4-5.5% YoY seen in the previous two years amid a very gradual decline in unemployment from 14.5% in 2022 to 12.0% as of September 2023. However, the unofficial employment, especially in the service sectors indeed could have increased following the recent inflows of 100,000 refugees.

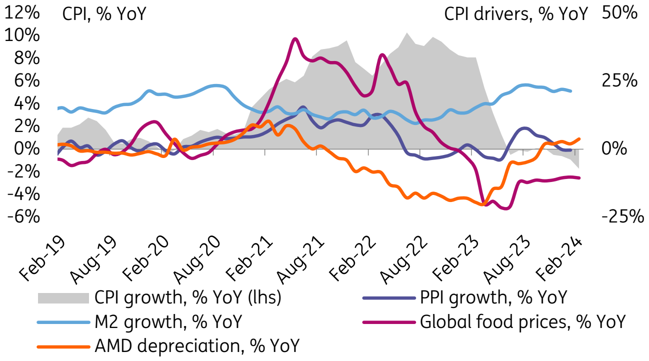
Keeping that in mind, the CBA has been rather cautious in its rate cut cycle, reducing the step to just 25bp (to 8.50%) in its most recent March meeting, while we pencilled in a more aggressive move. This cautiousness might reflect the exhaustion of most of the external and exchange-rate related disinflationary factors (except for the global food prices) amid elevated domestic monetary supply growth. We now see CPI ending the year at 3.5-4.0% YoY and the key rate at 7.50%, with further downside limited given the likely recovery in the CPI to 4-5% levels in 2025. The upward price pressures on the real estate market, which can intensify following the recent Russia-related bank card news (an official rent agreement is required for an average immigrant to open an account in an Armenian bank), is likely to remain the pro-inflationary risk factor in the longer run.

Fig 9 Armenia: Inflation and key rate



Source: National sources, CEIC, ING

Fig 10 Armenia: Inflation drivers

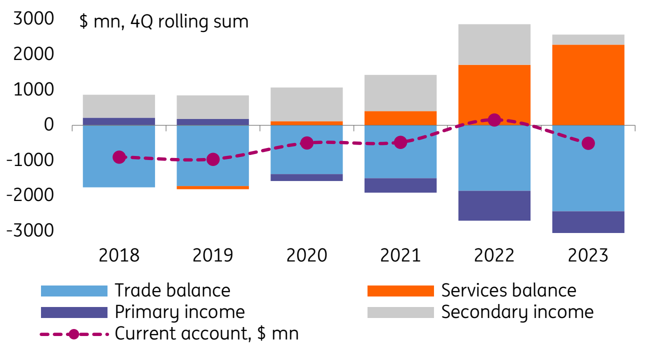


Source: National sources, CEIC, UN FAO, ING

Balance of payments and exchange rate. The headline current account deficit number of US$0.5bn in 2023 as well as remittances data, are pointing at a normalisation after an abnormal surplus year 2022. However, the structure of the overall balance of payments remains somewhat stretched, with the widening trade deficit (amid a strong dram) being financed by a bigger services surplus (thanks to immigration and other effects of the post-2022 geopolitical reality). Meanwhile, the drop of net private capital inflow from a standard US$0.5-1.0bn pa to zero in 2023 is pointing at a reversal of some of Russia-related inflows and moderation in the FDI inflows. In our view, this configuration leaves the dram, so far, the strongest performing CIS-4 currency, vulnerable to depreciation risks.

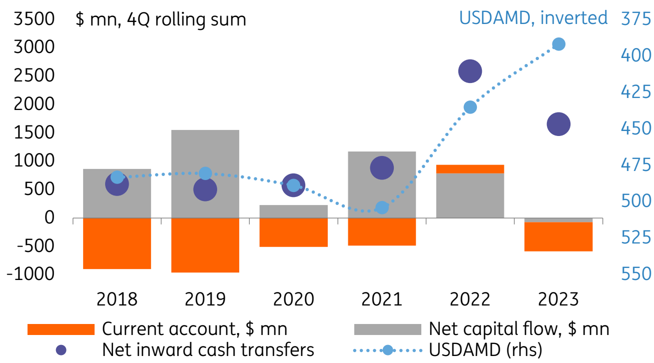
The decision to stop processing Russian-issued Mir bank cards starting 2Q24 to comply with the global sanction regime, is likely to affect the financial flows related to c.65,000 Russian immigrants who live in Armenia but normally receive their income from Russia (salary, property income, etc). While previously Russians had the opportunity to use their savings without becoming clients of Armenian banks, now opening an account and subsequent transfers may become the preferred option. We believe this will support the current trend of normalisation of the remittance inflow after the 2022-23 spike. Meanwhile, unless it leads to a significant relocation of Russians away from Armenia and or forces them to sever their financial ties with Russia (which does not seem likely at this point), Armenia will continue to receive capital inflows from Russia in one form or the other.

Fig 11 Armenia: Current account evolution + composition



Source: National sources, CEIC, ING

Fig 12 Armenia: Balance of payments vs AMD



Source: National sources, CEIC, ING

Fig 13 Armenia: **Rating drivers/sensitivities, factors that could lead to an upgrade or downgrade**

Agency	Upgrade factors	Downgrade factors
Moody's Ba3 (STABLE)	• Recent inflows of capital and labour are sustained, driving productivity growth and fiscal strength. • A durable easing in geopolitical tensions with Azerbaijan, from a peace agreement.	• Reversal in the financial or labour inflows received from Russia. • Resurgence in inflation that is not contained by monetary policy. • Escalation of tensions with Azerbaijan into full-scale conflict.
S&P BB- (STABLE) *(Next review 23 Aug)*	• Geopolitical risks are contained while strong growth continues. • Further strengthening of fiscal or external balance sheets.	• Material reversal in financial and labour inflows from Russia. • Macroeconomic fallout triggered by escalation of conflict with Azerbaijan, or geopolitical tensions with Russia.
Fitch BB- (STABLE) *(Next review 26 July)*	• **Fiscal**: Fiscal consolidation and reduction in FX share of government debt. • **Macro**: Durable high growth rates that increase GDP per capita.	• **Fiscal**: Substantial increase in government debt/GDP from growth slowdown or fiscal loosening. • **External**: Increase in current account deficits or decline in international reserves. • **Structural**: Materialisation of geopolitical risks that hit financial stability.

Source: Moody's, S&P, Fitch, ING

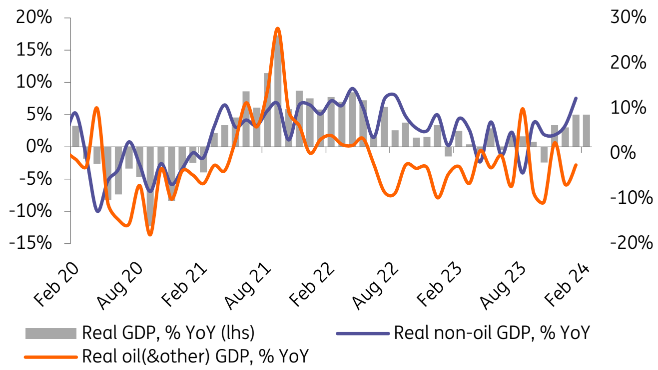
Azerbaijan

Economic overview

Azerbaijan has lagged its CIS peers in terms of economic performance, largely due to volatility in commodity extraction, but 2024 should bring some normalisation. Financially, the country remains exceptionally strong, with fiscal revenues beating expectations and the current account surplus remaining highly positive. Monetary policy has some scope for easing given the noticeable disinflationary trend. Meanwhile, the key issues remain the same – from ageing oil fields and a weak institutional framework to persisting foreign policy risks related to tensions with neighbouring Armenia.

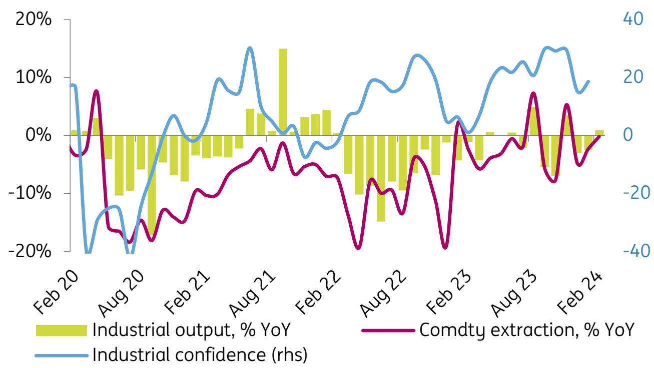
Economic activity. Azerbaijan's key economic performance indicators are showing signs of a moderate rebound. After an extremely sluggish 0.4-0.6% YoY in 1H23, the country's GDP accelerated to 1.7-1.8% YoY in 2H23. The overall 2023 result of 1.1% YoY is still weak compared to 4.7-5.6% seen in the previous couple of years but is slightly better than our initial expectations. The non-oil sector is leading the recovery, but the oil sector is also showing cautious signs of improvement. In 2024, we expect to see 2.5% growth in overall GDP driven mainly by the non-fuel sector. The fuel sector should also post growth thanks to the development of the gas fields, but the maturation of the country's oil fields may lead to volatility in commodity extraction growth.

Fig 14 Azerbaijan: GDP growth dynamics and composition



Source: National sources, CEIC, ING

Fig 15 Azerbaijan: Key indicators of industrial production

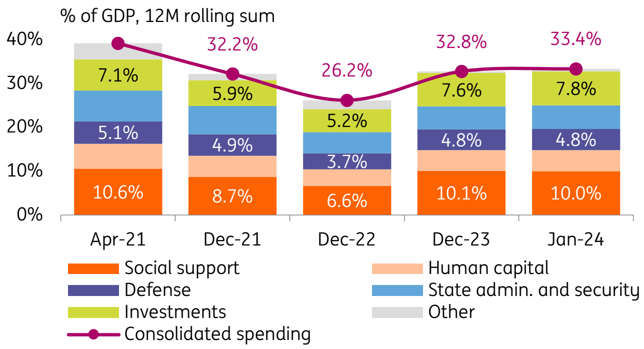


Source: National sources, CEIC, ING

Budget policy. For 2023, Azerbaijan reported an 8.2% GDP surplus of the consolidated budget system, which represents a widening from the 5.4% GDP surplus of 2022 and exceeds our expectations. The main reason for the outperformance was strong revenues, which jumped by 9.3ppt of GDP in 2023, out of which 5.4ppt were attributable to the revenues of SOFAZ, the sovereign oil fund which receives the main bulk of the fuel revenues. In 2023, the Azerbaijan government received US$213m of annual revenues per each US$1 of oil price, which is a dramatic increase compared to c.US$150m in 2021-22, suggesting a de facto increase in the fuel tax burden (given that fuel exports declined, as will be shown later in the text). Fiscal breakeven oil price dropped to US$54/bbl in 2023, the lowest level since 2019. Non-fuel revenues also improved in 2023, but to a lesser extent.

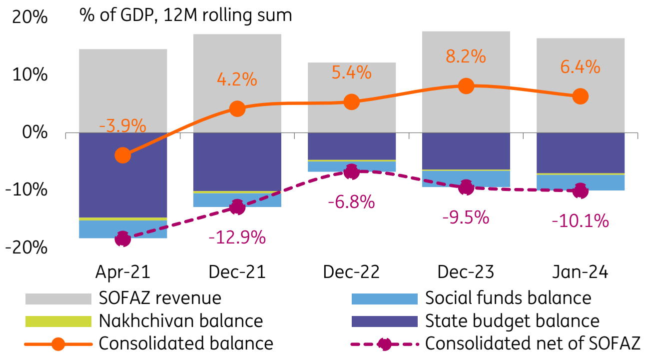
Consolidated expenditures increased in 2023, largely in line with our expectation, reflecting higher social support, public investments, and military spending. The continued foreign policy tensions with Armenia suggest that the upward pressure on the military spending is likely to persist in the future. As a result, we remain certain of the continued spending growth and widening in the non-fuel deficit. However, the country's large fuel revenues are likely to remain an offsetting factor, leading to overall surpluses of c.5% GDP in the coming years.

Fig 16 Azerbaijan: Consolidated budget spending



Source: National sources, CEIC, ING

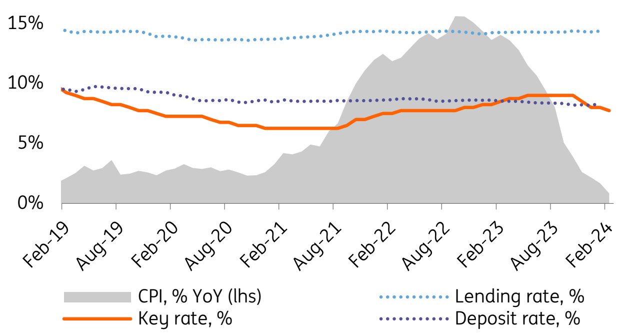
Fig 17 Azerbaijan: Components of consolidated budget balance



Source: National sources, CEIC, ING

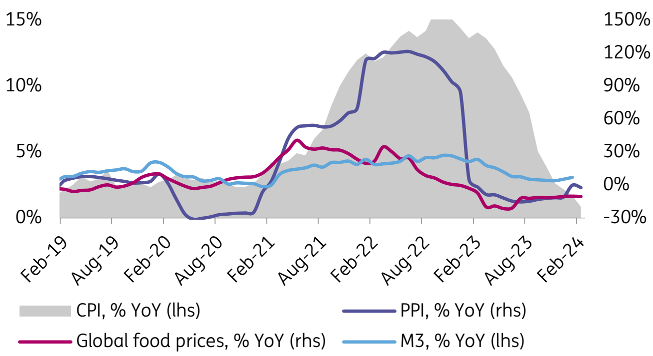
Inflation and monetary policy. As in most cases in our coverage space, Azerbaijan's inflation continues to underperform expectations. CPI growth slowed from 14.4% YoY at the end of 2022 to 2.1% YoY in December 2023 and just 0.8% YoY as of February 2024 amid exhaustion of Covid- and Russia-related spikes in pro-inflationary factors in 2021-22. The slowdown in CPI to the lower bound of the official target range of 2-6% allows the central bank to proceed with the key rate cut. The current easing cycle started in November 2023, and we see the key rate at 7.0% by year-end 2024 and 6.0% at the end of 2025, representing 50bp and 150 bp downside from the current level of 7.50%. This view is made under an assumption that CPI will start recovering in 2H24 and reach 4-5% by the year-end amid expiration of the low base effect and accumulation of monetary supply growth before settling at around 3% by year-end 2025.

Fig 18 Azerbaijan: Inflation and key rate



Source: National sources, CEIC, ING

Fig 19 Azerbaijan: Inflation drivers

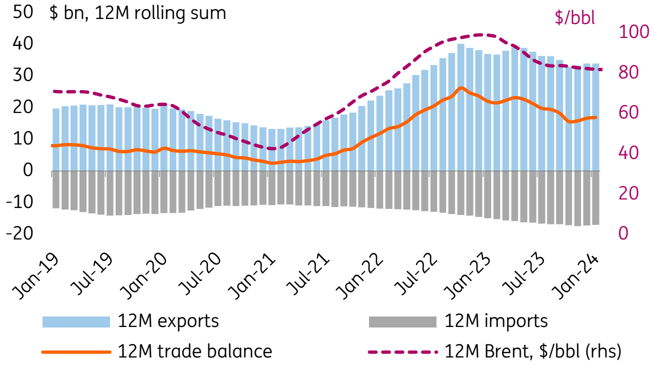


Source: National sources, CEIC, UN FAO, ING

Balance of payments. Azerbaijan's external balance remains strong despite some normalisation after one-off excesses of 2022. The country's current account surplus shrank from US$23.5bn in 2022 to US$8.3bn in 2023, matching the 2021 number. Fuel exports declined from US$37.9bn to US$25.9bn reflecting both a US$17/bbl drop in the Brent price and a decline in annual fuel exports per US$1/bbl of oil price from a peak of US$380m in 2022 to a more normal uS$320m. The latter corresponds to an almost 20% drop in fuel export volumes in physical terms after a 40% spike in 2022. Meanwhile imports posted a 21% YoY increase, reflecting higher domestic consumption and investments. The trade balance is the primary driver of balance of payment normalisation following the geopolitics-related spike in the current account surplus in 2022. The external surplus related to the current account is being routinely sterilised through FX purchases by the central bank, maintaining the USDAZN at the pegged 1.7

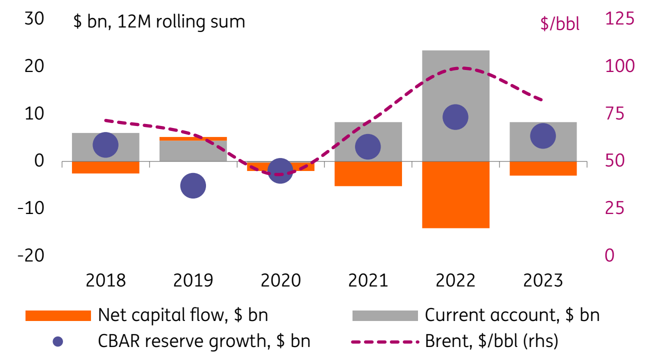
level. While we expect the current account surplus to continue to shrink amid stagnation of oil exports and growing imports – leading to an increase in the current account breakeven oil price - it is likely to remain positive around 10% of GDP in the foreseeable future.

Fig 20 Azerbaijan: 12M trade balance composition



Source: National sources, CEIC, ING

Fig 21 Azerbaijan: 12M balance of payments composition



Source: National sources, CEIC, ING

Fig 22 Azerbaijan: Rating drivers/sensitivities, factors that could lead to an upgrade or downgrade

Agency	Upgrade factors	Downgrade factors
Moody's Ba1 (STABLE)	• Further progress in reforms to improve governance, transparency and policy predictability. • Economic diversification that reduces dependence on hydrocarbons. • Increased gas production and exports from non-oil sectors to outpace lower oil output.	• Signs of erosion in the credibility and effectiveness of the policy framework. • Banking sector weaknesses resurfacing, raising contingent liability risks. • Renewed geopolitical tensions with Armenia.
S&P BB+ (STABLE) *(Next review 7 Jun)*	• Sustaining high external surpluses for further accumulation of external assets. • Reforms that improve diversification of economy and monetary policy effectiveness.	• Declining oil production weighs on fiscal balances. • Falling hydrocarbon receipts weigh on GDP per capita growth. • Geopolitical tensions with Armenia escalate again.
Fitch BB+ (POS) *(Next review 26 Jul)*	• **Fiscal**: Continued expenditure restraint, in line with fiscal rule, or sustained high energy prices. • **External:** Further strengthening of external balance sheet, eg, through energy exports. • **Macro:** Improvements in policy predictability and framework.	• **Fiscal:** Significant fiscal loosening or additional material contingent liabilities. • **External:** Lower energy prices that could significantly reduce exports. • **Macro:** Reduced confidence in policy framework.

Source: Moody's, S&P, Fitch, ING

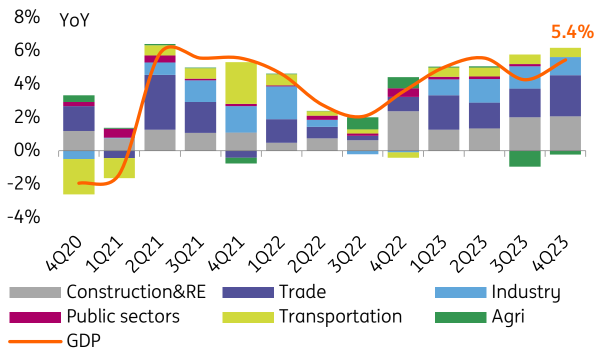
Kazakhstan

Economic overview

Kazakhstan had a successful 2023, showing solid GDP growth, better-than-expected fiscal performance, slowdown in the CPI, easing in the monetary policy, and a stronger-than-expected currency. We are confident that this year disinflation and the key rate cut cycle are likely to continue, but all the other positive trends will be put to a test. Economic activity is showing signs of slowdown, fiscal revenues are dependent on volatile non-tax items, while a widening in the current account deficit and government intention to limit the spending of sovereign oil fund may pose a challenge to the strength of the tenge.

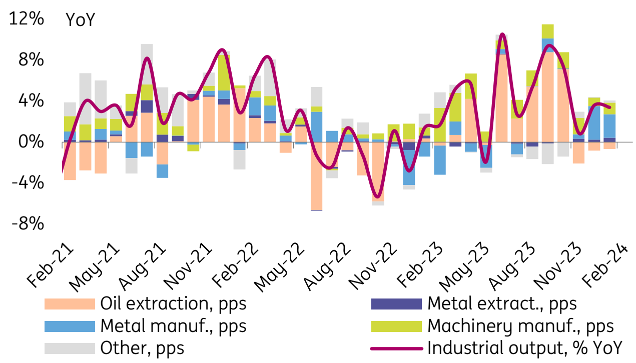
Kazakhstan posted solid 5.1% GDP growth in 2023, the highest rate since 2013, slightly outperforming our expectations. The brief slowdown of 3Q23 was related to the agriculture sector, and the growth structure of 4Q23 suggested strong performance in the key sectors, including trade, construction, and industrial output, despite the adverse base effect of 4Q22. Meanwhile, looking into 2024, the monthly activity indicators are somewhat mixed. On the one hand, oil production is ever volatile, providing little support to the industrial production and the overall growth in the beginning of the year. On the other hand, corporate lending growth is somewhat faster at 13% YoY in January, while retail lending is still posting growth rates close to 30% – both suggesting some momentum in the non-oil sector. We are somewhat cautions in forecasts, expecting some cooling in the GDP growth to around 4% this year amid possible delays at the Tengiz oilfield, moderation in the post-Covid and geopolitics-driven recovery and normalisation of foreign trade.

Fig 23 Kazakhstan: GDP growth dynamics and structure



Source: National sources, CEIC, ING

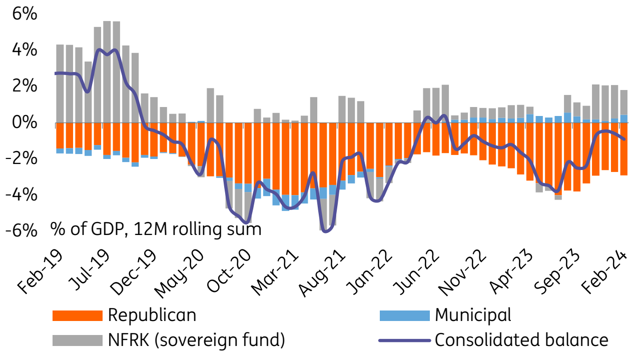
Fig 24 Kazakhstan: Industrial production growth and structure



Source: National sources, CEIC, ING

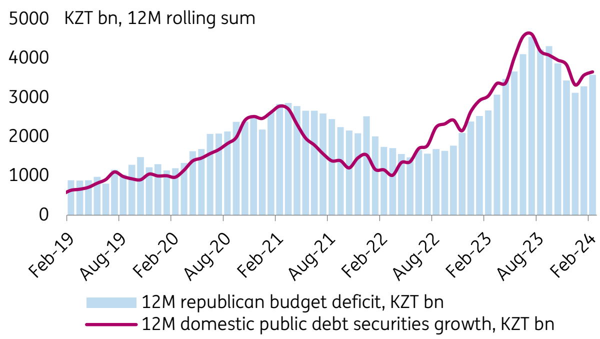
As with the case of Azerbaijan, Kazakhstan's fiscal performance turned out to be stronger than we expected – the consolidated deficit narrowed from 1.3% of GDP in 2022 to 0.5% of GDP in 2023 instead of widening. However, the main reason for this outperformance was the 2.9ppt jump in the investment income of NFRK, the sovereign fund. Meanwhile, overall expenditures showed a 1.7ppt increase, largely in line with expectations. As a result, outside of the NFRK-related items, the republican budget did post some widening in the deficit from 2.3% to 2.6% of GDP, driving the domestic public debt growth. Looking ahead, we continue to see upward pressure on the state spending related to social and investment spheres, while the ability to boost the tax revenue side has yet to be confirmed. As a result, we see a high likelihood of the consolidated deficit widening to 1.0-1.5% of GDP, while the tightening in the fiscal rule (reduced spending of NFRK) should translate into republican deficit of around 2.5-3.0% of GDP.

Fig 25 Kazakhstan: Consolidated budget balance composition, 12M



Source: National sources, CEIC, ING

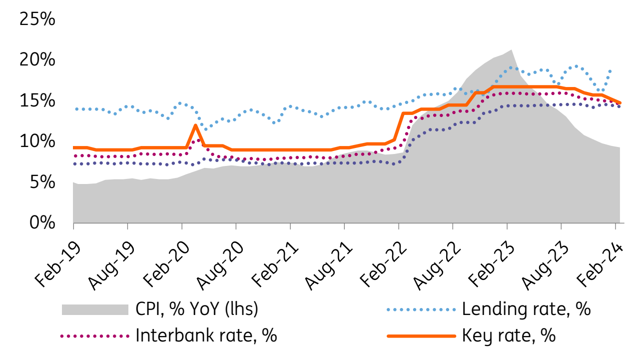
Fig 26 Kazakhstan: Republican deficit and domestic debt growth



Source: National sources, CEIC, ING

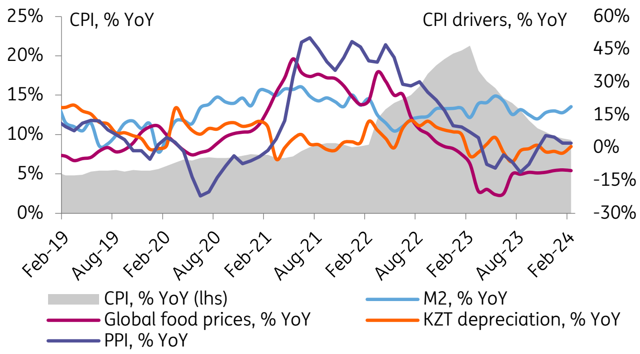
Inflation and monetary policy. Kazakhstan's inflation is slowing down largely in line with expectations. Over the course of 2023 the CPI growth rate halved from 20.3% to 9.8% YoY and fell to 9.1% YoY in March 2024. Easing in the inflationary pressure allowed NBK, the central bank, to initiate the rate cut cycle in 2H23, and we expect it to continue in 2024. We believe the key rate still has 225ppt downside until the year-end, to the level of 12.50%, assuming CPI slows to 8.0%. Further scope for the key rate cut in 2025 would appear more modest given the exhaustion of the disinflationary factors. So far, global food prices keep favouring slower food CPI, but the dynamics of producer prices, monetary supply growth and exchange rate performance suggest that the period of sharpest CPI slowdown in Kazakhstan has likely passed. There is still a long way until inflation reaches the NBK target of 5%.

Fig 27 Kazakhstan: Inflation and key rate



Source: National sources, CEIC, ING

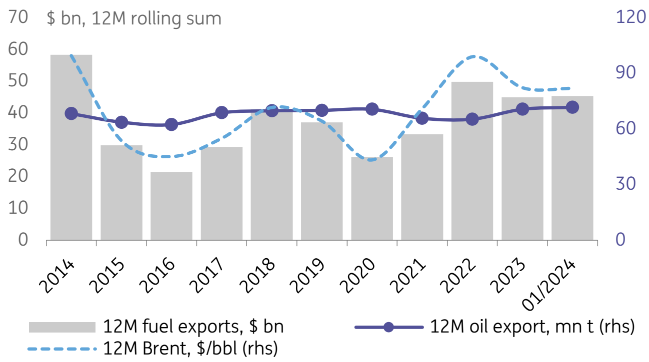
Fig 28 Kazakhstan: Inflation drivers



Source: National sources, CEIC, UN FAO, ING

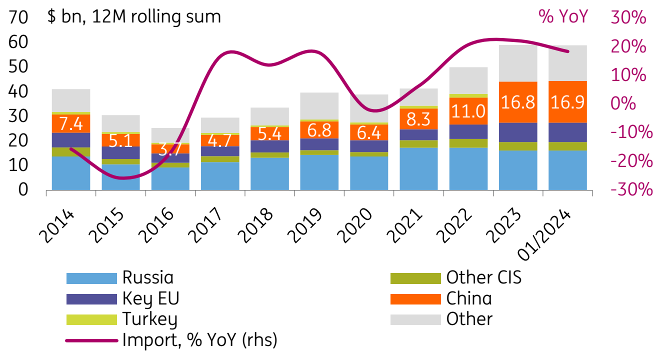
Balance of payments and exchange rate. In line with initial expectations, the trade balance, the key component of Kazakhstan's external balance, saw normalisation in 2023 after the geopolitics-driven positive shock of 2022. Last year, despite some 8% recovery in the physical volume of oil exports, overall export value dropped 7% mainly reflecting lower oil prices. Meanwhile, imports grew 22% in 2023 after 21% in 2022, mainly on higher trade with China, leading to a 45% shrinking in the trade surplus. The current account, having shown an atypical surplus of US$7.1 bn in 2022, returned to the highly negative area of a US$8.7bn deficit, which is in line with a typical situation for Kazakhstan. Looking forward, some slowdown in the import growth (related to overall economic slowdown) should provide some support to the trade balance, putting some limit to the widening in the current account deficit, but unless Kazakhstan manages to significantly boost its exports, the annual current account deficit should widen to around US$11bn in 2024, or close to 4% of GDP.

Fig 29 Kazakhstan: Fuel export volume and value



Source: National sources, CEIC, ING

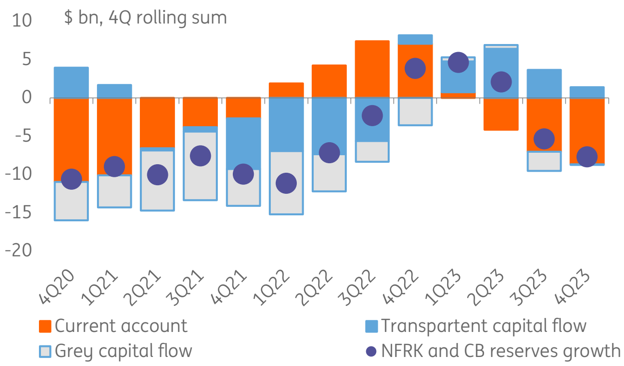
Fig 30 Kazakhstan: Import growth and geographical composition



Source: National sources, CEIC, ING

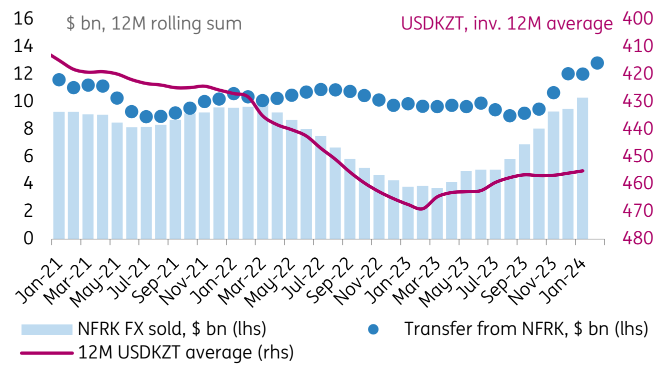
Looking more broadly, the entire structure of Kazakhstan's balance of payments has largely returned to the standard picture, as the spike of private capital inflow seen in the beginning of 2023 is also over. The gap created by the trade and private capital flows is now almost fully covered by the state capital flows almost exclusively represented by the spending of the sovereign oil fund (NFRK) for the purposes of the budget. The cumulative FX sales out of NFRK increased from US$9.8bn in 2022 to US$12.0bn in 2023, being the primary support for the tenge and explaining its outperformance vs expectations at the end of the year. Meanwhile, we note that given the planned tightening in the fiscal rule (which means reduced tapping of NFRK) suggests possible reduction in the state support to the tenge in the medium term. As a result, we continue to expect USDKZT to return to a weakening trend in 2024-25, in line with balance of payments fundamentals.

Fig 31 Kazakhstan: Balance of payments composition, 4Q rolling sum



Source: National sources, CEIC, ING

Fig 32 Kazakhstan: FX sales out of sovereign fund and USD/KZT



Source: National sources, CEIC, ING

Fig 33 Kazakhstan: **Rating drivers/sensitivities, factors that could lead to an upgrade or downgrade**

Agency	Upgrade factors	Downgrade factors
Moody's Baa2 (POS)	• Further reforms to strengthen institutional framework and policy credibility. • Accelerated process of economic diversification, to expand growth drivers. • Continued trend of greater economic stability and rising incomes.	• A significant and long-lasting deterioration in economic and fiscal metrics. • Crystallisation of domestic political risks, such as a re-emergence of social unrest.
S&P BBB- (STABLE) *(Next review 23 Aug)*	• Track record of reforms accelerates non-oil growth and political stability. • Monetary policy effectiveness improves through low inflation, exchange rate flexibility and reduced dollarisation. • Easing of geopolitical risks.	• A significant decline in oil exports due to disruption to the CPC pipeline. • Worsening fiscal and external position, including from strong import growth.
Fitch BBB (STABLE) *(Next review 17 May)*	• **Structural/Macro:** Strengthening of economic policy framework and diversification. • **Fiscal:** Sustained improvement in fiscal performance leading to stronger sovereign balance sheet.	• **Structural**: Spillovers from Russia-related sanctions or domestic political instability. • **Fiscal:** Deterioration of sovereign balance sheet due to commodity price shock or contingent liabilities. • **Macro:** Deterioration of policy mix that undermines predictability of monetary policy.

Source: Moody's, S&P, Fitch, ING

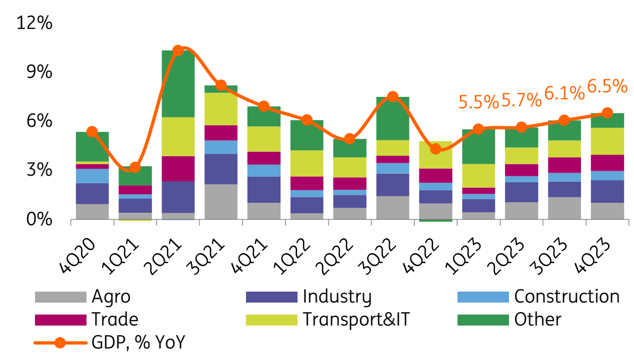
Uzbekistan

Economic overview

Uzbekistan macro dynamics have been largely in line with our initial expectations. Economic activity is showing stable growth, supported by relations with neighbours and apparently financed by the state. The 2.1ppt drop in unemployment to 6.8% during 2023 amid the growing labour force was the biggest positive news. Inflation, key rate, and the soum are also moving in line with expectations. At the same time, a decline in transparency of the fiscal data is a bit of a concern. The government's ability to proceed with tariff liberalisation for the households, and its effect of inflation and the fiscal performance will be a key watch factor for 2024.

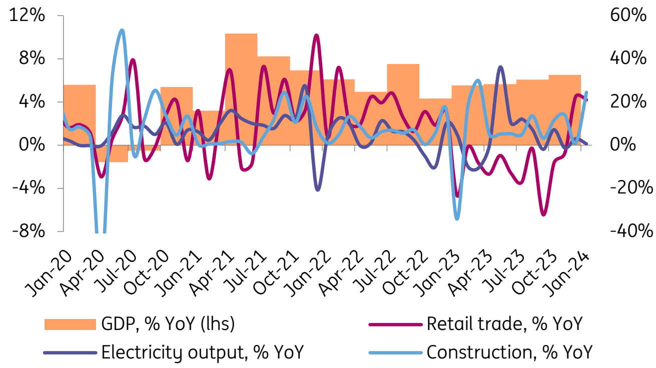
Economic activity. Uzbekistan's GDP growth accelerated from 5.7% in 2022 to 6.0% in 2023, close to our initial expectations. The growth rate has been picking up throughout the year, partially aided by the statistical base effect. The decline in unemployment is the biggest positive development, especially given the continued growth in the labour force. However, there are several concerns regarding the GDP growth structure, including the volatility in retail trade, construction, and electricity output. Also, the activity growth does not seem to resonate much with the banking sector data, where corporate lending is declining in real terms. Meanwhile, the reliance of consumption on borrowing is growing, with retail lending growing by 35% YoY in real terms.

Fig 34 Uzbekistan: GDP growth dynamics + composition



Source: National sources, CEIC, ING

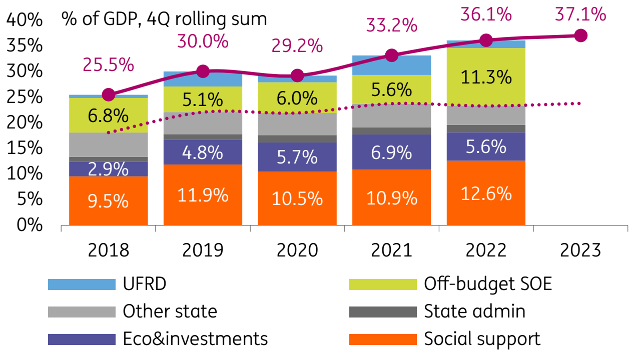
Fig 35 Uzbekistan: Key economic activity indicators



Source: National sources, CEIC, ING

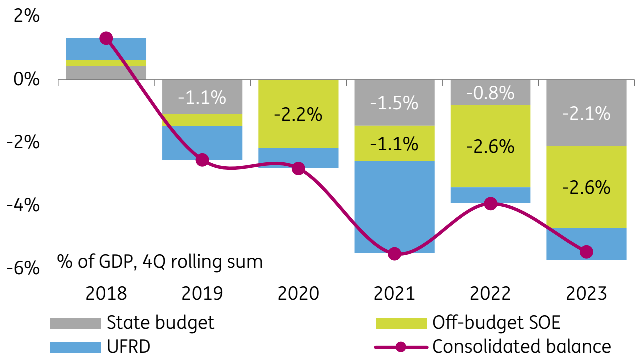
Fiscal policy. In 2023, the transparency of fiscal data somewhat declined, which is a bit of a concern in terms of government commitment to relevant macro data disclosure. Meanwhile, according to various estimates, including the IMF and rating agencies, the consolidated budget deficit widened from 3.9% of GDP in 2022 to 5.5% of GDP in 2023, close to our initial expectations (5.0-5.5%) amid higher spending related to public investments and social support as well as underperformance in revenues due to the delayed energy tariff increase. For this year we are hoping for some consolidation, assuming the government will proceed with the energy tariff reform for households, however, we would not exclude that it will require some extra social spending as well. Overall, the fiscal policy is unlikely to become restrictive anytime soon, but it doesn't seem that it will remain an easily available growth support tool given the continued growth in public debt amid the decline in the sovereign fund (UFRD).

Fig 36 Uzbekistan: Consolidated budget expenditure composition



Source: National sources, IMF, Fitch, CEIC, ING

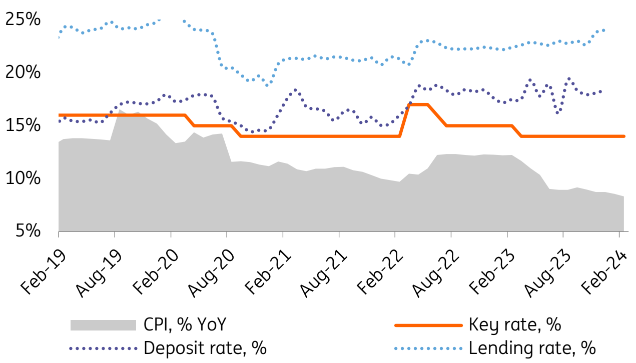
Fig 37 Uzbekistan: Consolidated budget balance composition



Source: National sources, IMF, Fitch, CEIC, ING

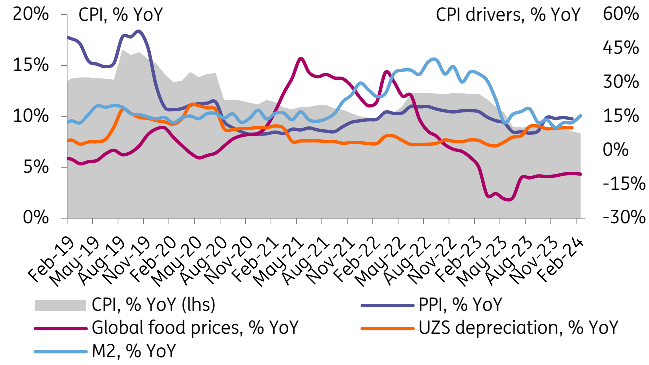
Inflation and monetary policy. Inflationary pressure in Uzbekistan eased somewhat in 2023, but challenges remain. First, the liberalisation in the wholesale energy tariffs has led to a spike in PPI in 4Q23, which may somewhat pass-through into CPI later. Secondly, the upcoming liberalisation of retail energy tariffs in May 2024 remains a major factor of uncertainty for the CPI trend in 2024. We do not exclude a temporary spike from the current 8% YoY to double-digit territory. Finally, the continued domestic currency depreciation prevents any material improvement in the inflationary expectations. As a result, the central bank has been reluctant to cut the key rate, currently at 14.00%. We believe that any easing would become realistic only after the tariff liberalisation-related dust settles, meaning the first cut at the very end of 2024 (at the earliest).

Fig 38 Uzbekistan: Inflation and key rate



Source: National sources, CEIC, ING

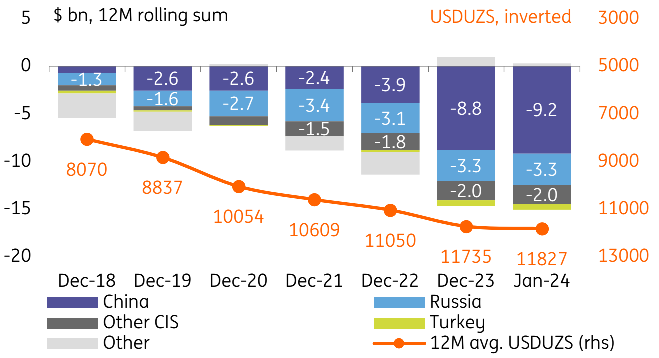
Fig 39 Uzbekistan: Inflation drivers



Source: National sources, CEIC, UN FAO, ING

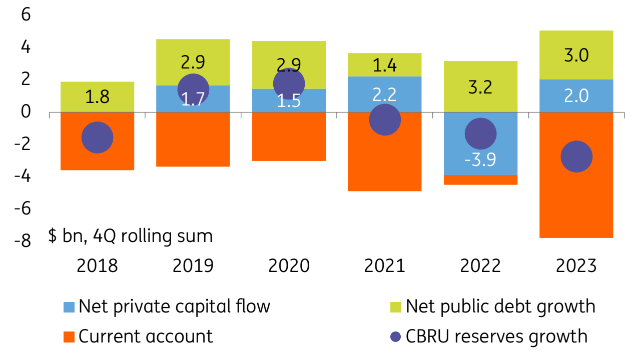
Balance of payments and exchange rate. Uzbekistan's external balance is also developing in a mostly predictable way. While the trade deficit continues to widen, largely due to increased imports from China, the overall current account stopped benefitting from the temporary Russia-related non-trade inflows. As a result, the overall structure of the balance of payments is back to the pre-2022 profile, with a current account deficit being financed through public capital inflows – through accumulation of debt and spending of the sovereign fund. That said, the widening in the current account deficit is exceeding expectations: in 2023 it totalled US$7.8bn, materially larger than the 2018-21 range of US$3-5bn and adding to the pressure on the soum, which depreciated by 6% to USD in 2023 after 4-5% in 2021-22. We expect this trend to continue into 2024-25 unless import growth moderates and/or an improvement in the business climate amid the state reform agenda leads to some accelerated repatriation of the private capital.

Fig 40 **Uzbekistan:** **Balance of goods and services vs USD/UZS**



Source: National sources, CEIC, ING

Fig 41 **Uzbekistan:** **Balance of payments composition**



Source: National sources, CEIC, ING

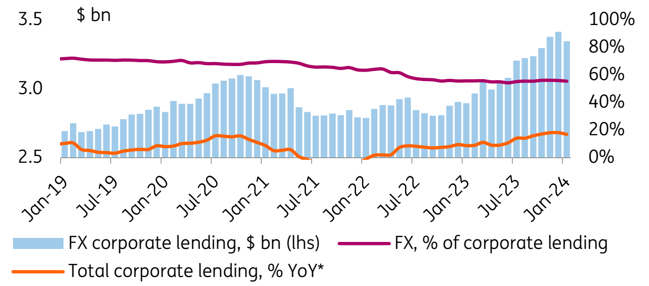
Fig 42 **Uzbekistan:** **Rating drivers/sensitivities, factors that could lead to an upgrade or downgrade**

Agency	Upgrade factors	Downgrade factors
Moody's Ba3 (STABLE)	• Further progress in structural reforms to improve competitiveness. • Deepening of domestic capital markets to reduce reliance on foreign currency debt.	• Permanent weakening in real GDP growth and worse fiscal metrics. • Persistent widening in current account deficits without increased foreign investment. • Domestic political instability hinders the pace of reforms.
S&P BB- (STABLE) *(Next review 31 May)*	• Economic reforms result in stronger growth potential and increased fiscal revenue. • Increased integration with the global economy drives diversification of export receipts.	• Negative spillovers from the Russia-Ukraine conflict drive weaker fiscal and external positions. • Weaker financial performance of SOEs leads to the transfer of contingent liabilities to the government balance sheet.
Fitch BB- (STABLE) *(Next review 23 Aug)*	• **Fiscal:** Consolidation that enhances medium-term debt sustainability. • **Macro:** Structural reforms that boost GDP growth prospects. • **Structural:** Improvement in governance standards.	• **Fiscal:** Marked rise in government debt due to period of low growth or crystallisation of contingent liabilities. • **External:** Worsening in external position due to large drop in remittances or widening in the trade deficit.

Source: Moody's, S&P, Fitch, ING

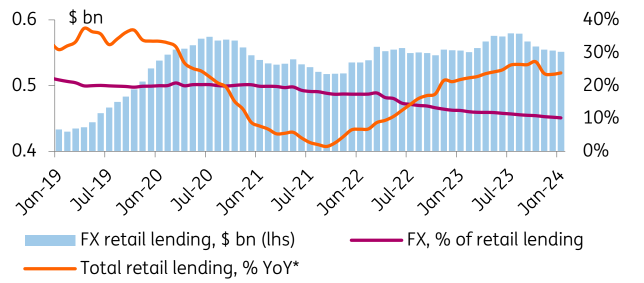
Appendix
CIS-4 banking sector lending chart book

Fig 43 Armenia: Corporate lending (25% of GDP)



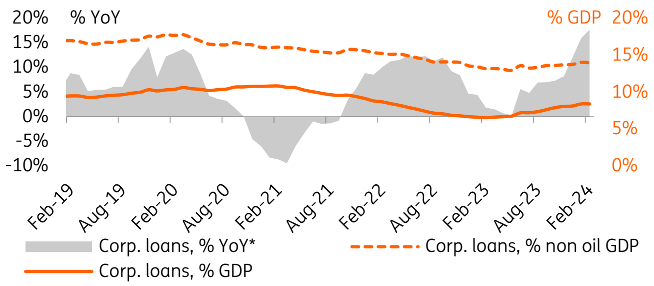
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 44 Armenia: Retail lending (23% of GDP)



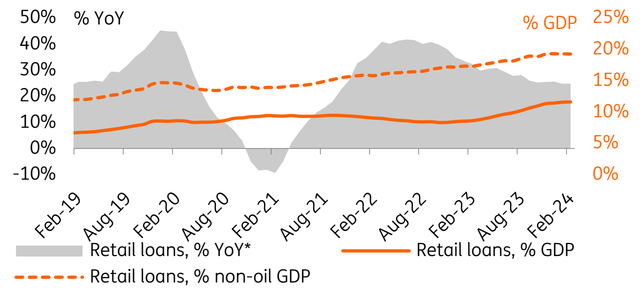
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 45 Azerbaijan: Corporate lending (8% of GDP)



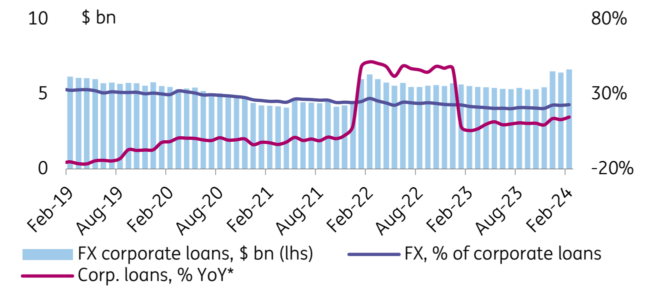
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 46 Azerbaijan: Retail lending (12% of GDP)



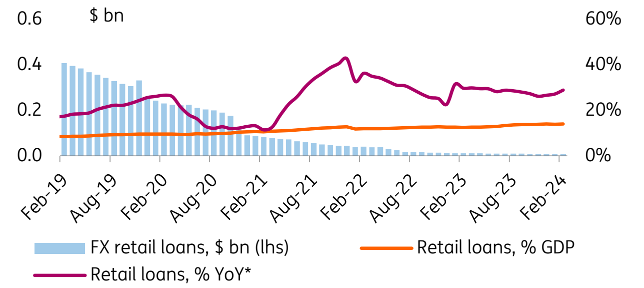
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 47 Kazakhstan: Corporate lending (11% of GDP)



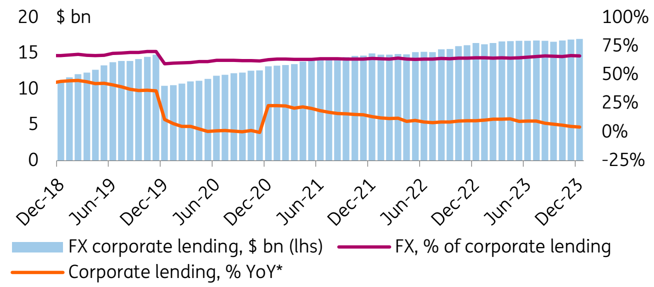
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 48 Kazakhstan: Retail lending (14% of GDP)



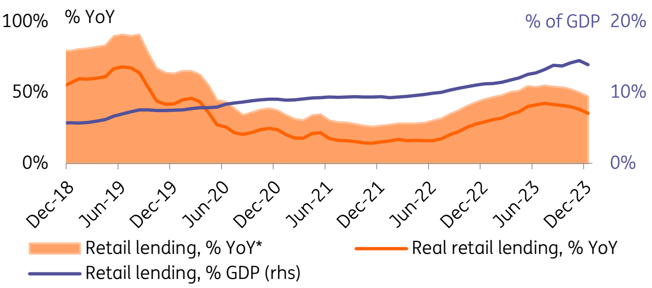
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 49 Uzbekistan: Corporate lending (30% of GDP)



*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Fig 50 Uzbekistan: Retail lending (14% of GDP)



*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

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