26 March 2025
EM macro and credit

Note: This is a non-investment research report and does not include the investment strategies and trade recommendations contained in the Global Markets Research version to be found on research.ing.com

CIS macro and credit

When in doubt, play to your strengths

Contents

The CIS is facing the new round of global uncertainties mostly in a decent shape. Commodity exporters should be able to benefit from the rise in global defence spending and higher demand for gold, but oil breakevens and currency valuations should be watched closely. Room for fiscal manoeuvre still exists, but consolidation is more likely and desirable, in our view. Elevated risks of inflation and capital outflow call for a tighter monetary policy in the region. In the sovereign credit space, spreads look tight, but the region can be a decent diversifier for EM investors given the region is less clearly in the crosshairs of the US administration.

Country views

Over recent weeks most of the central banks in our CIS coverage space worsened their CPI outlooks and took a more hawkish stance, either opting to postpone a cut in the key rate, or to do an outright off-consensus hike. While there are some domestic country-specific stories behind this, it is also clear that the growing global uncertainties call for reinforcement in the capital accounts through higher real rates.

- **Armenia.** Risks include a lack of fiscal buffers, ties with Russia, and overvalued currency. Opportunities stem from a potential de-escalation with Azerbaijan and the development of gold mining projects.
- **Azerbaijan**'s economic activity is expected to moderate in 2025, with ample fiscal buffers allowing the continued support of investment-driven industries despite pressures in oil production and a cautious monetary policy.
- **Kazakhstan** remains heavily dependent on fiscal policy, which is now heading towards a VAT hike in 2026. For the near term, we are constructive on KZT thanks to state FX sales, but medium-term prospects are less certain.
- **Uzbekistan** is undergoing long-awaited fiscal consolidation which restrains growth amid limited room for monetary easing. But its potential to ramp up sales of gold could be an opportunity given the growing global uncertainties.

Sovereign credit views

- The technical picture looks good, with a somewhat unusual trend for the region of most issuance out of the way early in the year, outside of Kazakhstan. However, spreads in general are fairly tight, leaving few attractive opportunities for significant tightening. We would view the region as a decent diversifier and well insulated against global trade tensions, with the potential to also benefit from positive geopolitical developments.

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

James Wilson
EM Sovereign Debt Strategist
james.wilson@ing.com

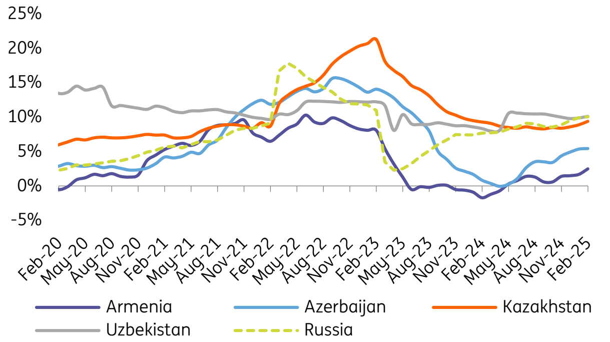
Key macro indicators for 2024-26F

	Armenia			Azerbaijan			Kazakhstan			Uzbekistan		
	2024A	2025F	2026F	2024A	2025F	2026F	2024A	2025F	2026F	2024A	2025F	2026F
GDP												
Real GDP (%YoY)	5.9	5.0	4.5	4.1	3.0	2.5	4.8	4.5	3.5	6.5	5.7	5.5
Nominal GDP (US$bn)	23.8	25.3	25.2	74.3	80.6	81.7	288.4	302.6	328.5	115.0	127.9	139.9
GDP per capita (US$)	8501	9016	9226	7284	7728	7765	14291	14769	15805	3050	3323	3561
Fiscal balance												
Consolidated budget balance (% of GDP)	-3.5	-4.8	-4.4	4.0	1.7	0.4	0.0	-1.8	-0.2	-4.3	-3.8	-3.2
Public debt (% of GDP)	50.3	52.5	53.7	20.5	20.9	23.6	23.5	23.0	22.0	35.0	35.8	36.4
Fiscal breakeven Brent (US$/bbl)	n/a	n/a	n/a	64	66	68	80	108	73	n/a	n/a	n/a
Balance of payments												
Current account (% of GDP)	-3.9	-4.6	-4.7	6.3	5.8	2.8	-1.5	-1.9	-2.1	-5.3	-5.2	-4.5
Trade balance (% of GDP)	-7.9	-7.7	-6.4	11.9	9.7	7.1	6.7	6.7	5.6	-12.3	-11.4	-11.0
Foreign debt (% of GDP)	61.9	62.7	64.9	20.2	19.3	19.6	57.4	56.4	53.5	60.7	58.5	57.0
Current account breakeven Brent (US$/bbl)	n/a	n/a	n/a	64	59	63	88	84	82	n/a	n/a	n/a
CPI, Interest & exchange rate												
CPI (year-end, %YoY)	1.5	3.0	4.0	4.9	4.4	5.8	8.6	11.0	10.5	9.9	9.2	6.3
Central bank key rate (year-end, %)	7.00	6.50	6.50	7.25	7.50	8.00	15.25	16.50	15.00	13.50	13.50	12.00
Exchange rate vs USD (year-end)	397	416	437	1.70	1.70	2.21	524	530	565	12895	13411	13813

Source: National sources, CEIC, ING

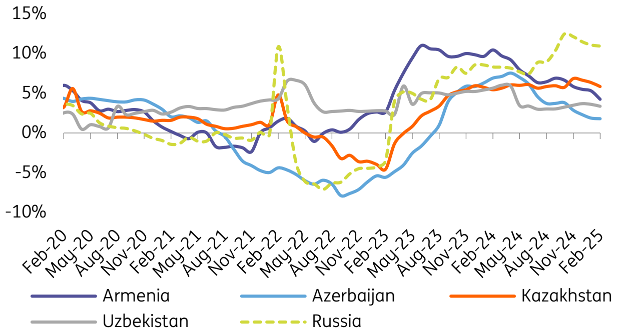
CIS cross-country overview charts

Inflation (% YoY)



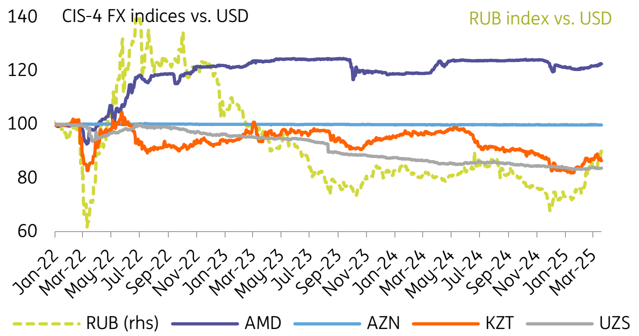
Source: National sources, CEIC

Real policy rates (%)



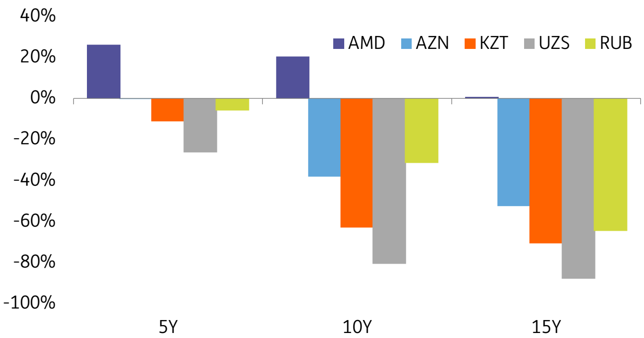
Source: National sources, CEIC, ING

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



Source: National sources, Refinitiv, CEIC, ING

Long-term performance of CIS currencies vs USD



Source: National sources, Refinitiv, CEIC, ING

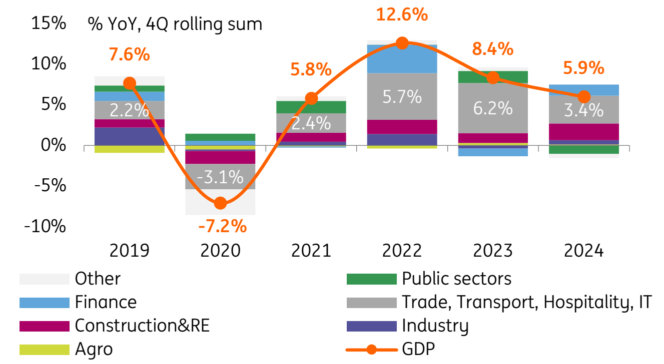
Armenia

External drivers of Armenia's activity, including high skilled immigration, remittances, and regional trade flows, are all moderating. This makes the local growth story increasingly dependent on domestic credit and budget support, putting the fiscal story back into the spotlight. The elevated CPI risks limit the scope for monetary easing. The dram remains overvalued in our view, and this may be extended for some time, depending on the prospects for the peace deal with Azerbaijan and geopolitical context in relation to Russia.

Economic activity. Armenian GDP growth slowed from the elevated 12.6-8.4% rates in 2022-23 to a more normal 5.9% in 2024, mainly reflecting moderation of the immigration-driven financial inflow that passed through to the country's consumer sectors. In 4Q24, the growth slowed to 3.7% YoY on additional pressure from the mining (-8.8% YoY) and manufacturing sectors (-4.5% YoY) due to delays in some of the investment and production projects.

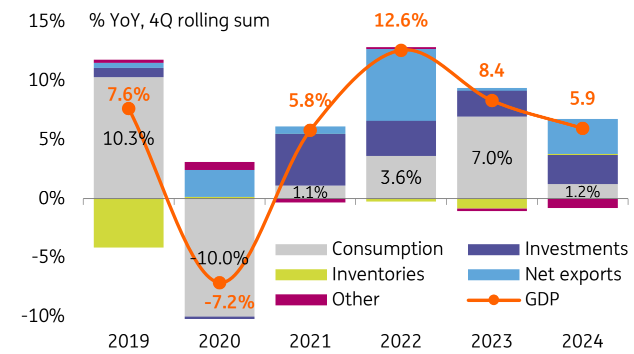
On the plus side, the growth is back to a more diversified structure both in terms of output sectors and usage. The continued strong growth in construction/investments is particularly welcome. In the meantime, the fact that nearly a half of 2024 growth was assured by net exports suggests increased vulnerability to various externalities, including peace negotiations with Azerbaijan, the geopolitical context in relation to Russia, and domestic developments in export-driven industries, including gold mining.

Armenia: GDP growth components by production



Source: National sources, CEIC, ING

Armenia: GDP growth components by usage

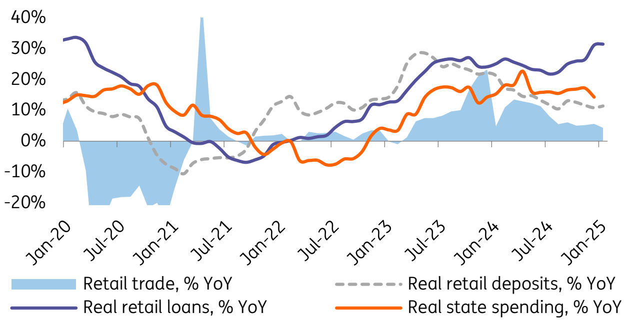


Source: National sources, CEIC, ING

The fundamentals of domestic consumption showed a mixed picture in 2024. On the one hand, employment increased by 5.2% (or by 38.7 thousand people), suggesting that the Armenian labour market managed to absorb the influx of c.65 thousand refugees from Artsakh (Nagorno Karabakh) to some extent. The fiscal policy (to be discussed further) also seems supportive. On the other hand, the widening gap between retail lending and deposit growth is hinting at a weakening income trend and a growing reliance of consumption on the credit, which is now close to a high level of 30% of GDP, split equally between mortgage and consumer loans.

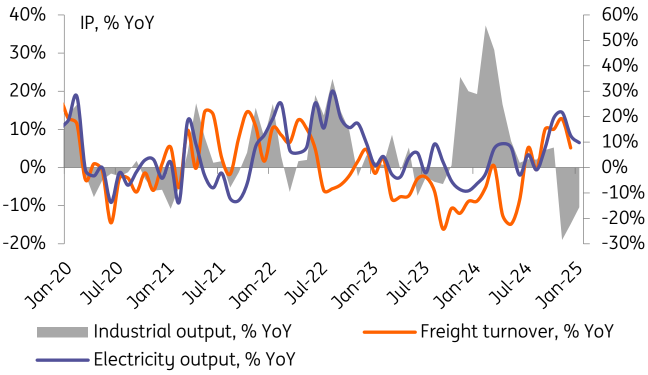
Industrial activity is proving to be volatile and heavily dependent on the schedule of mining projects and the country's participation in regional foreign trade, which seems to have peaked in the middle of 2024 but has moderated somewhat since then. On the plus side, corporate activity seems to have support from both domestic credit (corporate lending is up 25% YoY) and fiscal policy.

Armenia: Consumption activity indicators



Source: National sources, CEIC, ING

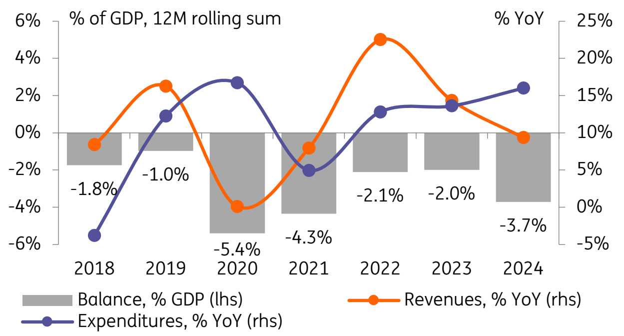
Armenia: Industrial activity indicators



Source: National sources, CEIC, ING

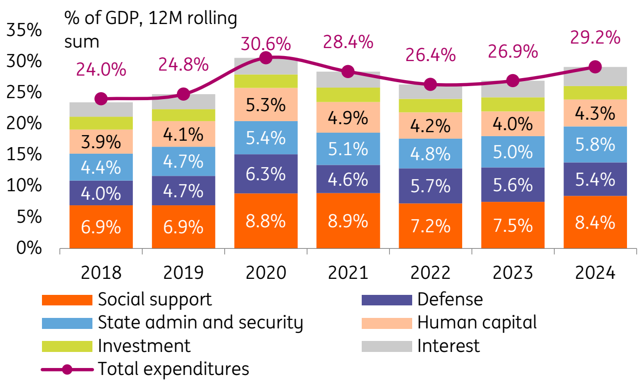
The budget policy has become more generous, largely in line with our previous expectations and official guidance. Although the revenue side has improved slightly, reflecting the government's attempt to reduce tax avoidance, expenditure has significantly increased, mainly due to higher social and defence spending, which seems unavoidable given the foreign policy context. The need to maintain high levels of spending is likely to persist given the social and defence initiatives, and we see a budget deficit in the 4.5-5.0% of GDP range in 2025-26 with the possibility of some moderation in 2027.

Armenia: Key budget parameters



Source: National sources, CEIC, ING

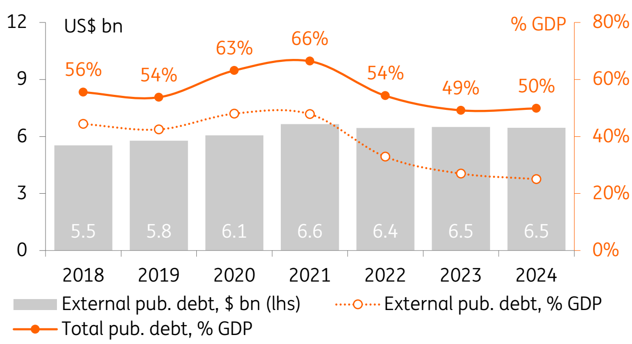
Armenia: Budget expenditure, 12M rolling basis



Source: National sources, CEIC, ING

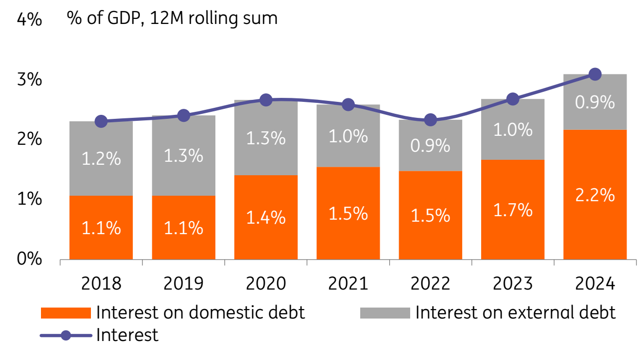
Wider fiscal deficits suggest greater upward pressure on Armenia's public debt. The overall level increased to 50% of GDP in 2024 after two years of decline in real terms, while interest expense increased to 3.1% of GDP, noticeably exceeding the previous historical highs. We believe the government will continue to prioritise domestic borrowing to contain risks stemming from the FX portion of its debt, but the capacity of the domestic market will be a watch factor. Armenia placed US$750m in 10Y Eurobonds in March 2025 to refinance the maturing papers and to finance the growing deficit.

Armenia: Key public debt parameters



Source: National sources, CEIC, ING

Armenia: Interest payments on public debt

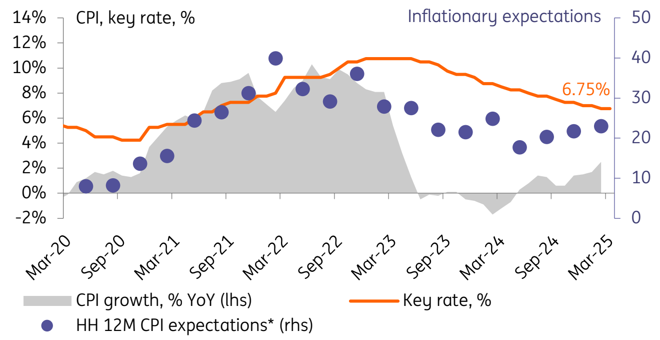


Source: National sources, CEIC, ING

Inflation and monetary policy. A more generous fiscal stance is apparently contributing to limiting the scope for further easing in the monetary policy. The central bank of Armenia (CBA) has recently lowered its long-term inflation target from 4.0% to 3.0% and taken a pause in the multi-year policy rate cutting cycle, leaving the policy rate unchanged at 6.75% in March. So far, CPI is still below the long-term target, at 2.5% YoY as of February 2025, and is currently on the rise from a very low base, driven mostly by global food inflation and other supply-side factors. Meanwhile, the cautious approach of the CBA seems logical given the abovementioned domestic fiscal considerations combined with rapid lending growth which is outperforming funding, especially on the retail side.

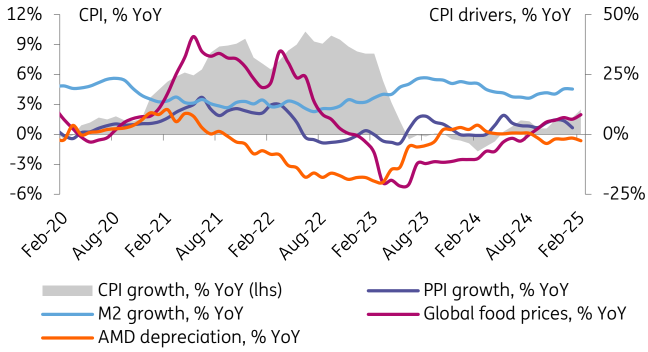
We see a continued gradual recovery of inflation to 3-4% as a base case for the coming years, which should minimise the downside for the key rate in the medium term. Meanwhile, the inflation and rate trajectory in Armenia is facing elevated uncertainty as, in addition to the global context related to the new US trade and tariff policies, there are externalities more directly related to Armenia, including the potential peace deal with Azerbaijan and ceasefire between Russia and Ukraine. We believe the former could be disinflationary through a prolonged period of AMD strength, while the latter could have mixed implications for Armenia as a result of lower support to AMD through remittances and trade flows on the one hand and lower domestic price pressures on the other.

Armenia: Inflation, expectations, and key rate



* % of households expecting fast to very fast price growth in the next 12M
Source: National sources, CEIC, ING

Armenia: Inflation drivers

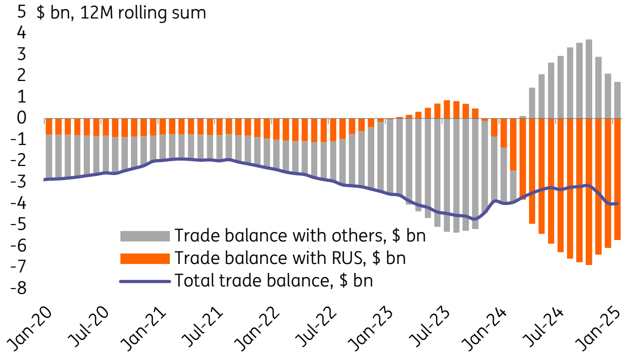


Source: National sources, CEIC, UN FAO, ING

Balance of payments and exchange rate. The main balance of payments indicators suggests that Armenia's trade and financial benefits resulting from the Russia-Ukraine conflict are largely through. The current account deficit has returned to the standard US$1bn in 2024 (4% GDP) as merchandise trade remained at a large 10% of GDP deficit as higher participation in regional trade boosted both exports and imports (and the volume of transactions started to moderate from mid-2024), while services exports and remittances inflows normalised along with immigrant inflows. Combined with the fact that AMD is strong relative to its peers and trade partner currencies, we continue to consider 3-5% depreciation vs USD as our base-case scenario for the coming years.

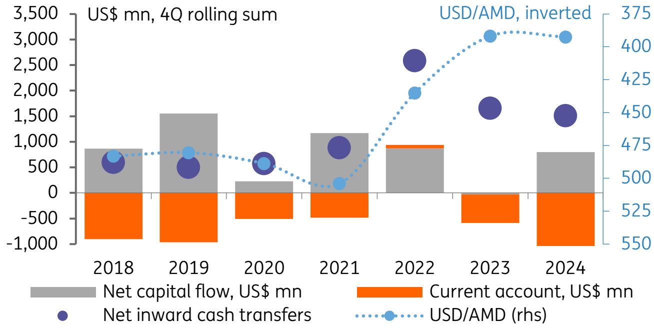
While the dynamics of the key items of Armenia's external trade and balance of payments suggest that the dram is overpriced, this period of overvaluation could be extended if favourable externalities keep Armenia's risk premium at a reduced level. Such externalities would include successful finalisation of a peace deal with Azerbaijan that could potentially unlock additional capital inflows. While the current situation surrounding the process is favourable, occasional skirmishes along the borders and Azerbaijan's criticism of the EU monitoring mission in Armenia remain risk factors. A potential Russia/Ukraine ceasefire would be largely neutral unless there are material changes in the sanction and trade restrictions on Russia, and for this to happen we believe a sustainable peace deal would be required.

Armenia: Trade balance level and composition



Source: National sources, CEIC, ING

Armenia: Balance of payments vs AMD



Source: National sources, CEIC, ING

Credit strategy

Recent progress on peace deal negotiations with Azerbaijan is a clear positive for sentiment, while the recent new Eurobond issue also reduces potential supply pressures for the rest of the year. However, with fundamentals generally stabilising from the big improvements seen in 2022 and some moderate fiscal pressures emerging, we view spreads as having squeezed too tight. We expect stable ratings at the BB- level, and no more hard currency supply for the rest of the year.

Amenia: 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)	• 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)	• **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

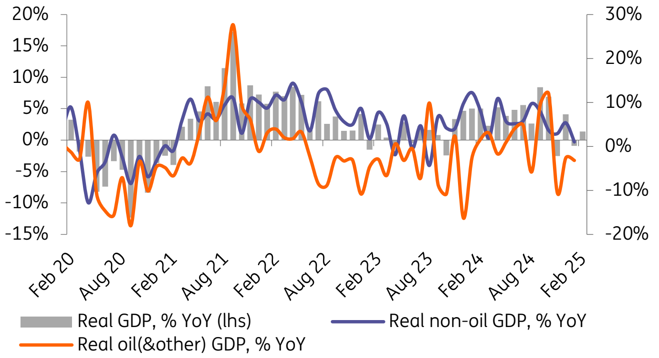
Azerbaijan

Economic overview

Azerbaijan's economic activity should moderate in 2025 after a strong spike in the non-fuel sectors last year, while pressures in oil production continue. Household consumption should lose some of the credit support, but the persistently generous fiscal policy should keep favouring the investment-driven industries. Meanwhile, the monetary policy stance should remain cautious given the growing CPI risks. Azerbaijan's more limited ties with Russia compared to other CIS countries in our coverage should limit the potential trade and financial flow impact of potential geopolitical shifts in the region. In the meantime, we continue to see the shrinking current account surplus as a watch factor for manat stability on a 2-3 year horizon.

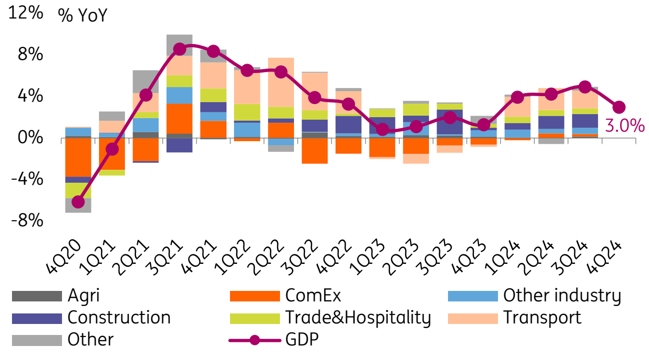
Economic activity. Economic growth momentum in Azerbaijan seems to be moderating, as full-year GDP growth was reported at 4.1%, after 4.7% YoY in 9M24. This slowdown reflected a reduced output from the non-fuel sectors, from 7.0% YoY in 9M24 to 3.9% YoY in 4Q24, most likely reflecting moderation in construction and transportation activity which drove the previous acceleration. The fuel sector managed to make a positive contribution for most of the year, but the overall dynamic remains volatile and generally sluggish, as the increased gas output is not expected to be enough to offset maturing oil production. We see GDP growth stabilising in the 2-3% range in the coming years.

Azerbaijan: GDP growth by key contributors



Source: National sources, CEIC, ING

Azerbaijan: GDP growth by sectors

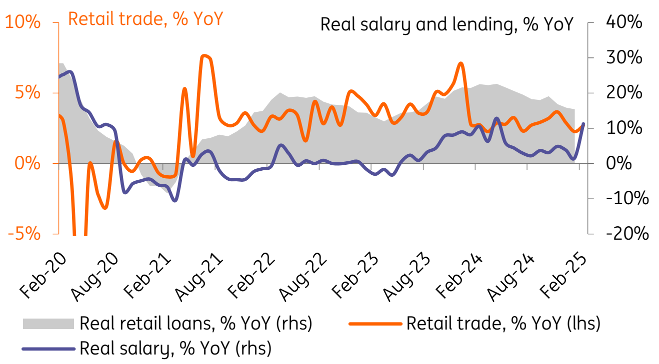


Source: National sources, CEIC, ING

The mood in the consumption-driven sectors seems to remain positive thanks to continued growth in real income and employment, as well as fast retail credit expansion. Meanwhile, as domestic retail loans are now 14% of GDP (23% of non-oil GDP) vs 8% (17%) in 2022, and growth in real terms has slowed from 23% YoY at the beginning of 2024 to 15-16% currently, consumption growth should moderate.

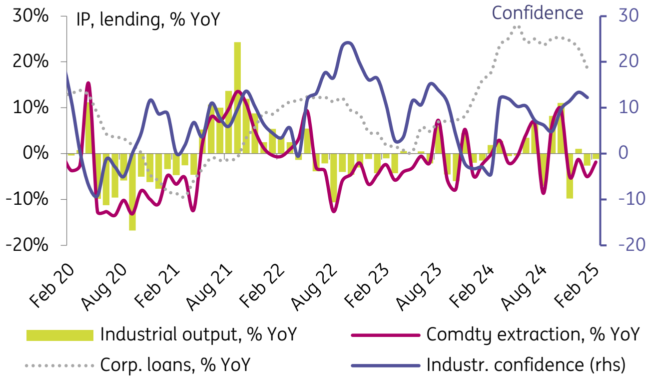
Corporate lending growth also slowed materially in 2024, reflecting a more cautious mood in some corporate segments. In the meantime, at 10% of GDP (16% of non-oil GDP), domestic corporate lending doesn't seem to be the primary source of financing and is not a sign of an overall slowdown. The direct indicators of industrial confidence continue to show strong readings despite sluggish activity in the oil sector, most likely reflecting the optimism surrounding Azerbaijan's fiscal policy, which remains generous.

Azerbaijan: Consumption fundamentals



Source: National sources, CEIC, ING

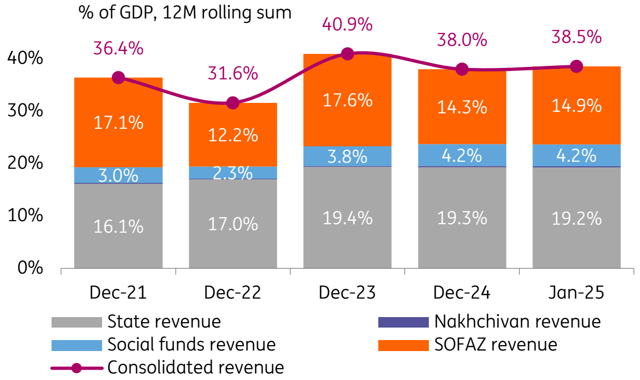
Azerbaijan: Key indicators of industrial activity



Source: National sources, CEIC, ING

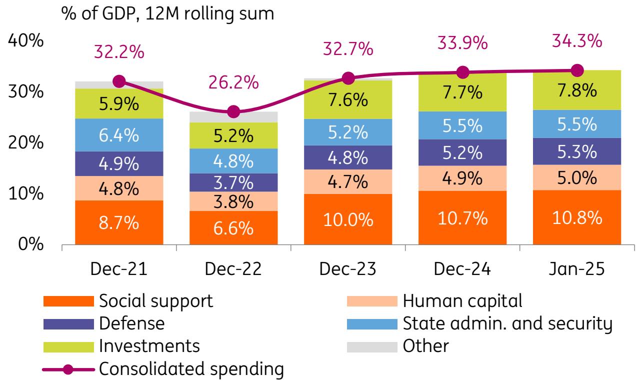
Budget policy. A looser fiscal stance was an important source of financing the somewhat above-expected GDP growth last year. On the revenue side, this was assured by the smaller receipts of SOFAZ, the state sovereign fund and the primary receiver of the fuel revenues. On the expenditure side, we saw continued growth in spending for most of the key items, including social support, human capital, defence and the state administration, only partially offset by some phasing out of investment spending, which however remained elevated by historical standards.

Azerbaijan: Consolidated budget revenues



Source: National sources, CEIC, ING

Azerbaijan: Consolidated budget spending



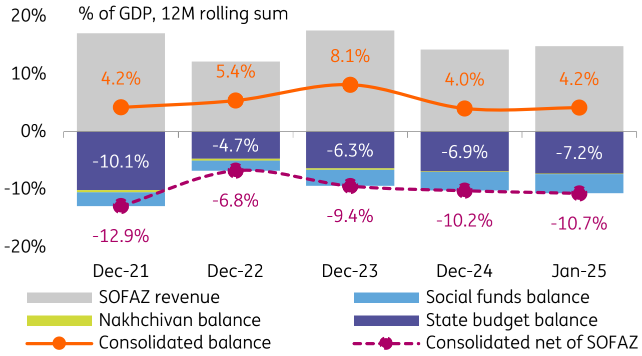
Source: National sources, CEIC, ING

As a result of these developments, the consolidated budget surplus halved from an exceptionally high 8.1% of GDP in 2023 to a more normal 4.0% in 2024. Meanwhile, net of transfers from SOFAZ, the deficit of the state budget widened from 4.7% of GDP in 2022 to 6.9% in 2024, while the overall budget system without the tax and investment income of SOFAZ widened from 6.8% to 10.2% of GDP.

Despite this easing, Azerbaijan's state finances remain solid, as the resulting budget breakeven Brent price totalled US$64/bbl, which is within the historical range of the past 10 years. Annual fuel proceeds per US$1/bbl of Brent prices are off their 2023 peaks, but at US$183m are also within range.

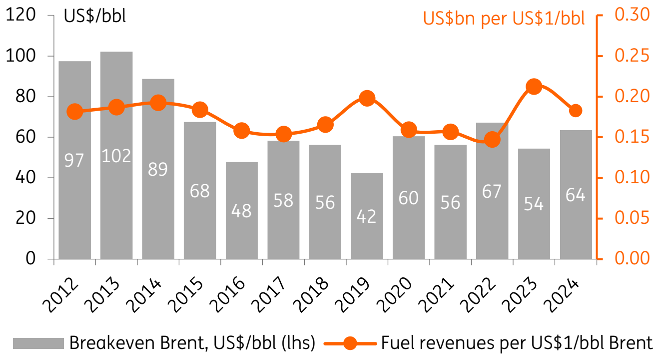
This suggests that the government of Azerbaijan still has the fiscal space to continue its generous approach despite a likely reduction in fuel revenue amid declining oil production. The growing appetite for state spending for social support, the military and investments is likely to be satisfied in the coming couple of years, likely leading to a decline in the consolidated budget surplus towards zero by 2026. This should be supportive of overall economic growth, especially in the non-fuel sectors, but will eventually put the issue of fiscal consolidation on the policy agenda.

Azerbaijan: Consolidated budget balance



Source: National sources, CEIC, ING

Azerbaijan: Budget sensitivities to oil prices

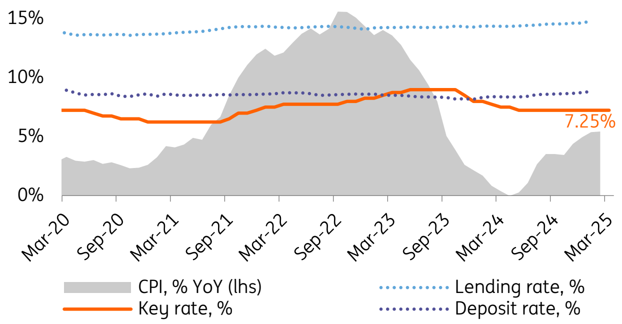


Source: National sources, CEIC, ING

Inflation and monetary policy. Easing in the fiscal stance was one of the factors contributing to the return of CPI from zero at the beginning of 2024 to 4.9% YoY at the end of the year and 5.4% YoY at the beginning of 2025. Other pro-inflationary factors are on the cost input side, including tariff indexations and global food price growth, while the manat's peg to USD and the resulting effective exchange rate appreciation versus trade partners serve as a mitigating factor.

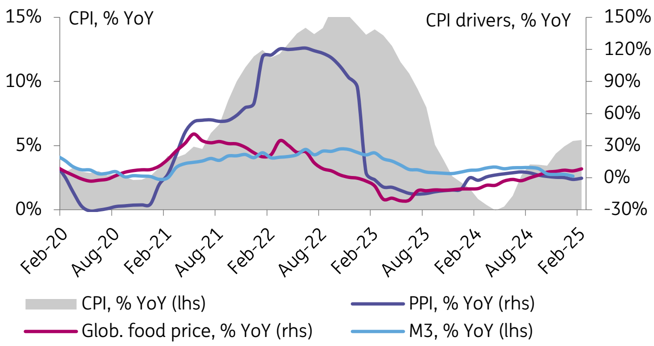
The CBRA, the country's central bank has recently maintained the key rate at 7.25% and indicated that it is comfortable with its official forecast of CPI reaching 5.5% YoY by the end of 2025, followed by a slowdown in 2026, suggesting expectations of CPI staying within the long-term target of 4±2% in the medium term. While we see this scenario as realistic, and do not exclude a small hike if CPI temporarily exceeds the 6% threshold in 2Q25. In any case, we see continued fiscal easing and the recent re-dollarisation of the bank's corporate funding base amid continued rapid growth in lending as arguments against any downside to the key rate this year.

Azerbaijan: Inflation and key rate



Source: National sources, CEIC, ING

Azerbaijan: Inflation drivers

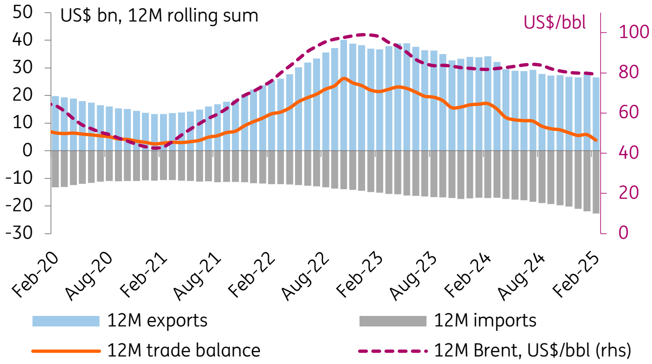


Source: National sources, CEIC, UN FAO, ING

Balance of payments and AZN. According to preliminary estimates, Azerbaijan's current account surplus shrank to US$4.7bn in 2024, or 6.3% GDP, which represents normalisation compared to the exceptionally high surplus of US$23.5bn (29.8% of GDP) of 2022, as exports, predominantly oil&gas, decline while imports continue to grow steadily. According to customs data, exports were down 22% in dollar terms while imports surged by the same 22% in 2024, leading to a material shrinking of the trade balance.

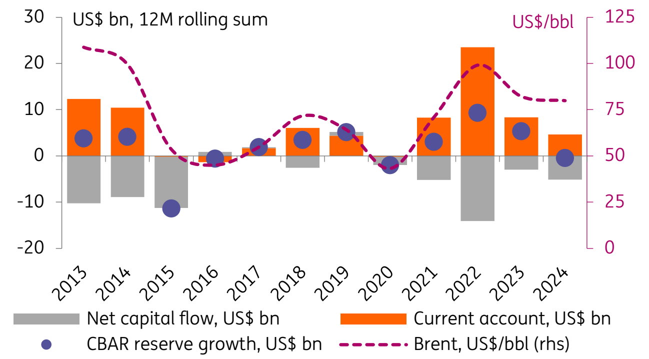
The financial account has remained in deficit, in line with Azerbaijan's normal model, which led to stagnation in the reserves for the first time since 2020, reiterating our focus on the growing vulnerabilities of Azerbaijan's balance of payments on a medium-term horizon.

Azerbaijan: 12M trade balance composition



Source: National sources, CEIC, ING

Azerbaijan: 12M balance of payments composition



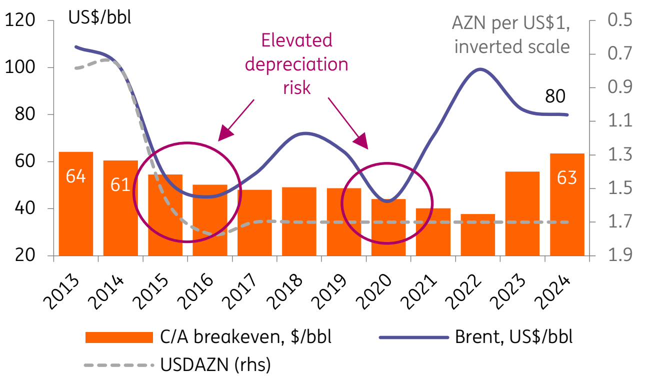
Source: National sources, CEIC, ING

The external balance of Azerbaijan remains solid, and the large buffers are underpinned by the country's sovereign fund SOFAZ and the CBAR reserves, together equivalent to c.100% of GDP. However, further developments on the balance of payments could be an important watch factor for FX stability.

The two key indicators to watch will be fuel revenues per US$1/bbl and the breakeven Brent price for the current account. First, in 2024, Azerbaijan received US$285m of annual fuel revenues per each US$1/bbl, which is in line with a typical historical range of US$250-300m. Meanwhile, the continued pressure on oil production could challenge the ability to boost or maintain this level in the long run. Second, if import growth continues, the Brent price needed for a balanced current account will continue to increase from the current US$63/bbl level, which is already an 11-year high.

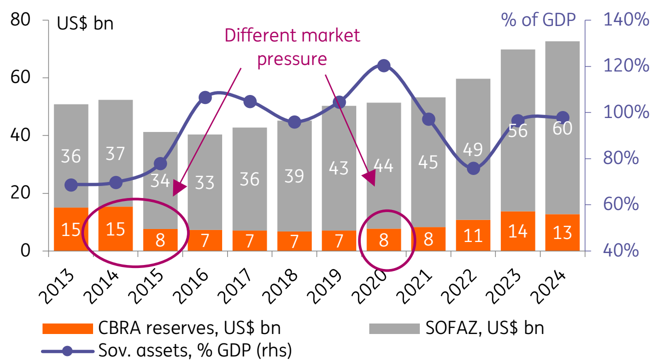
As a result, for now, we continue to see the USD/AZN peg at 1.70 as secure for the next 1-2 years. However, if the continued weakening of the current account fundamentals coincides with a continuous period of oil price weakness, this might renew market pressure on the manat. For now we identify the period of elevated FX risks for Azerbaijan beginning towards the end of 2026.

Azerbaijan: Current account breakeven



Source: National sources, CEIC, ING

Azerbaijan: External sovereign asset position



Source: National sources, CEIC, ING

Credit strategy

Credit fundamentals are strong given the significant FX assets and limited external financing needs, despite expectations for a moderation in the twin surpluses. Ratings are on the path to IG, with Fitch upgrading to BBB- last July and Moody's on positive outlook, which should bring official ratings in line with market perception and pricing. We see the potential for Moody's to upgrade this year, giving Azerbaijan its second IG rating and bringing the composite rating to IG. At the same time, progress towards a peace deal with Armenia has provided a slight uplift, leaving spreads now not looking too attractive versus the BBB-rated sovereign group. We expect new Eurobond issuance from the sovereign is unlikely.

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

Agency	Upgrade factors	Downgrade factors
Moody's Ba1 (POS)	• Further progress in reforms to improve governance, transparency and policy predictability. • Economic diversification that reduces dependence on hydrocarbons.	• 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)	• Sustaining high external surpluses for further accumulation of external assets. • Reforms that improve diversification of economy and monetary policy effectiveness. • Regional geopolitical risks subside	• Declining oil production weighs on fiscal balances. • Falling hydrocarbon receipts weigh on GDP per capita growth. • Geopolitical tensions with Armenia escalate again.
Fitch BBB- (STABLE)	• **Macro/structural:** Continued strengthening of the economic policy framework and institutional capacity that enhance Azerbaijan's capacity to absorb shocks. • **External finance:** Significant additional strengthening of the sovereign balance sheet resulting from higher energy revenues and a prudent policy mix.	• **Fiscal/external:** Significant erosion of the sovereign balance sheet. • **Macro:** A deterioration in the economic policy mix that, for example, results in macroeconomic and financial stability risks and/or increases Azerbaijan's vulnerability to external shocks including oil price volatility.

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

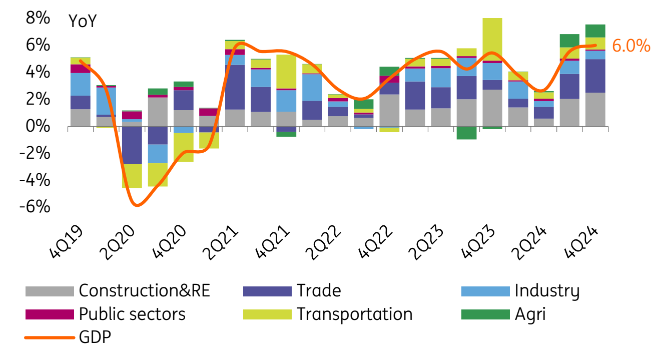
Kazakhstan

Economic overview

> Kazakhstan's macro case remains heavily dependent on the fiscal policy. A higher-than-expected budget deficit contributed to strong GDP growth and inflation, requiring the central bank to worsen the outlook and tighten its stance. This year, economic activity and the tenge will remain supported by the generous FX outlays from the sovereign wealth fund, but the looming fiscal consolidation of 2026, which will involve a VAT hike, is likely to translate into weaker GDP, a prolonged period of higher CPI, and reduced state support to the local FX market. Geopolitics remain a factor of uncertainty given that Russia accounts for one third of Kazakhstan's imports and 12% of exports. Since 2022, KZT has moved mostly in the same direction as RUB, with around 50% sensitivity at times of shocks. Meanwhile, as a commodity supplier, Kazakhstan could be better positioned in the context of higher global defence spending and trade wars.

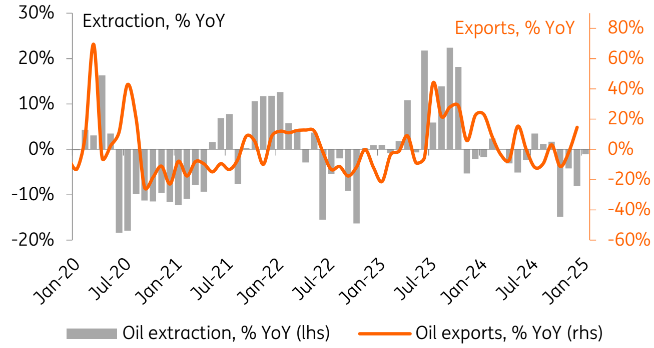
Kazakhstan's economic activity posted an impressive recovery from 3.2% YoY in 1H24 to 5.6-6.0% YoY in 2H24, resulting in overall 4.8% growth for the full year, exceeding expectations. Non-fuel sectors, including trade, construction and agriculture, led the recovery after a temporary flood-related hiatus, while oil-related activity remained under pressure. The near-term signals on the fuel sector are mixed, with overall oil production and export targets still suggesting growth thanks to Tengiz as from 2H25, but somewhat more modest than earlier expected due to additional maintenance at key oilfields and the need to comply with OPEC+ commitments after overproduction. Non-fuel sectors are likely to remain key in determining overall activity growth in 2025.

Kazakhstan: GDP growth dynamics and structure



Source: National sources, CEIC, ING

Kazakhstan: Key oil sector indicators

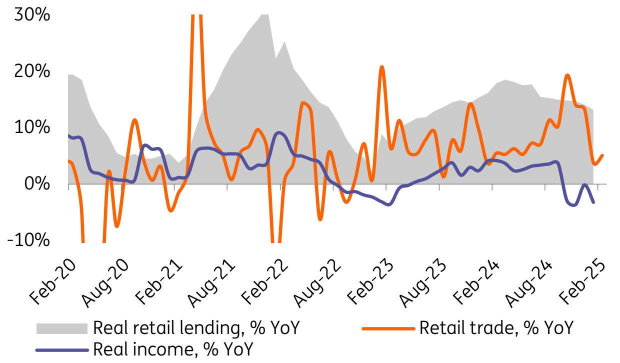


Source: National sources, CEIC, ING

Household consumption enjoyed a rapid increase throughout 2024, as retail trade increased 9% driven by 2% growth in employment and real income, as well as a noticeable 14% growth in retail lending in real terms. Meanwhile, in 2H24, the growth rates in household income and lending somewhat softened, and the prospects of the CPI and monetary policy, to be discussed below, suggest that the momentum for consumption may slow down in 2025. This is the primary reason **we expect overall GDP growth to moderate to 4.0-4.5% this year**.

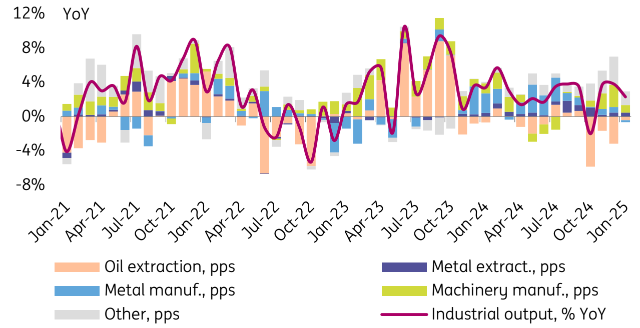
Corporate activity growth on the non-fuel industrial side appears more stable, with the focus shifting from metals to machinery manufacturing and other sectors amid a modest participation from the corporate lending side. Outside of the industrial sectors, activity remains volatile and less reliable, although the fiscal policy framework, to be discussed in the next section, is likely to provide some support in the near term.

Kazakhstan: **Consumption fundamentals**



Source: National sources, CEIC, ING

Kazakhstan: **Industrial output composition**

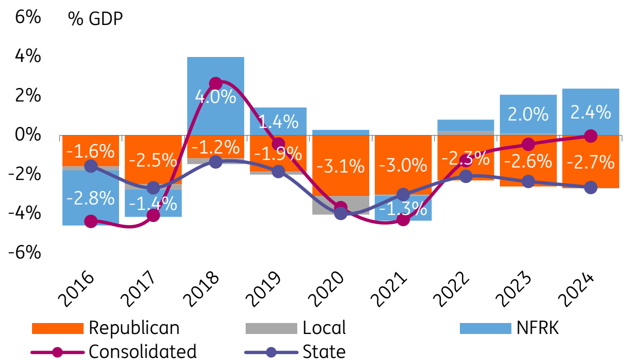


Source: National sources, CEIC, ING

Budget policy remains one of the central topics in Kazakhstan's macro case affecting growth, inflation and exchange rate prospects in the medium term. One of the key reasons for the positive surprise in the GDP growth for 2024 was a looser-than-expected fiscal stance. Due to continued weakening in the tax revenue collection amid sticky expenditures, the deficit of the state budget continued to widen to 2.7% GDP in 2024, exceeding our 2.0-2.5% expectations. The overall consolidated budget system managed to post a balance largely thanks to the abnormally high 3.7% of GDP investment income of NFRK, the sovereign wealth fund.

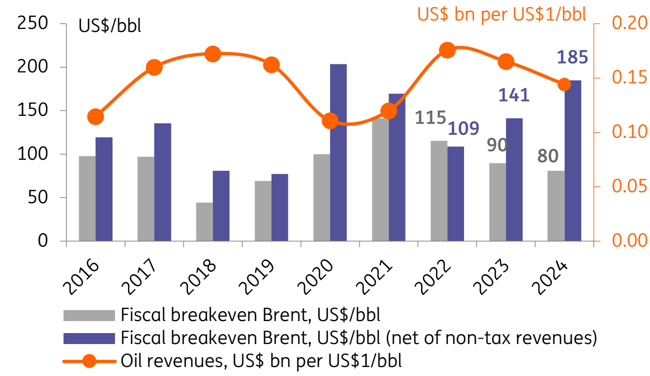
Netting out all the non-tax revenues, which, in addition to the abovementioned NFRK investment income, includes privatisation income and other proceeds, Kazakhstan's overall budget system was in deficit of 5.3% of GDP in 2024 vs just 0.8% of GDP in 2022. This represents a significant fiscal easing and a material increase in vulnerability to the oil price swings. Excluding the one-off proceeds, the fiscal breakeven oil price for Kazakhstan jumped from US$109/bbl in 2022 to as high as US$185/bbl in 2024, a post-Covid high. Meanwhile, the fuel revenues are constrained by the production and export volumes – over the past two years, the budget's annual fuel earnings have declined from US$176m to US$144m per US$1/bbl of Brent.

Kazakhstan: **Consolidated budget balance**



Source: National sources, CEIC, ING

Kazakhstan: **Budget sensitivities to oil prices**



Source: National sources, CEIC, ING

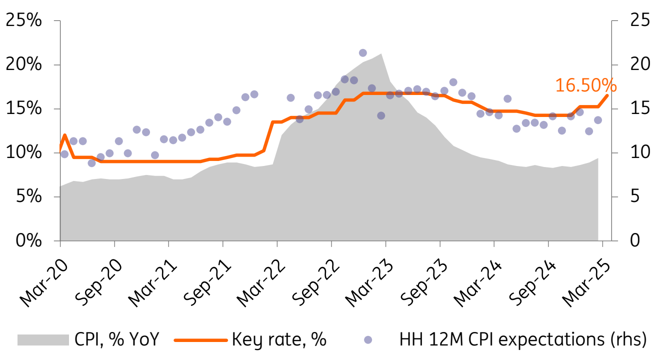
Not unexpectedly, the government recently announced measures aimed at fiscal consolidation, which will be formally considered by the parliament in 1H25 subject to final approval mid this year. According to these proposals, starting 1 January 2026, the VAT rate will increase from 12% to 16% and collection requirements will be tightened. According to official estimates, this should bring in additional revenue of 2.5-3.0% of GDP with a temporary side effect of 2.5-3.0 percentage points of additional inflation. The decision to approach fiscal consolidation through the revenue side is not surprising given the sticky nature of public spending, which historically has been relatively sticky. However, the preference to increase taxation on consumers rather than oil or non-oil corporates might suggest prioritisation of corporate activity over inflation targeting.

Given that fiscal consolidation is expected to take place in 2026, this year's fiscal framework should remain growth-supportive, in line with our initial expectations, and we see the republican budget in 2-3% of GDP deficit despite the persistent 3-4% of GDP transfer from NFRK. For 2026 onwards, assuming the current proposals are largely implemented, we conservatively expect the republican budget's own revenues to increase by 1.5-2.0ppt of GDP, which would lower the need to spend NFRK's oil savings while keeping the debt financing requirement close to current levels.

Inflation and monetary policy. The upside risks to inflation mentioned in our previous reports, are now materialising. The disinflation trend observed until 4Q24 has now stopped. A combination of renewed global food price growth, temporary pressure on the tenge, as well as domestic factors, such as fiscal easing and tariff increases led to a material acceleration in CPI from 8.3% YoY in September 2024 to 9.4% YoY in February 2025, significantly exceeding expectations, including that of the central bank NBRK. Having incorporated this and the new pro-inflationary inputs, such as a new round of freight tariff increases in 2025 and a VAT hike in 2026, the NBRK raised the key rate to 16.50% in March and increased its official year-end CPI expectations by 3.5 percentage points to 10-12% for 2025 and to 9-11% for 2026 (vs the long-term target of 5%).

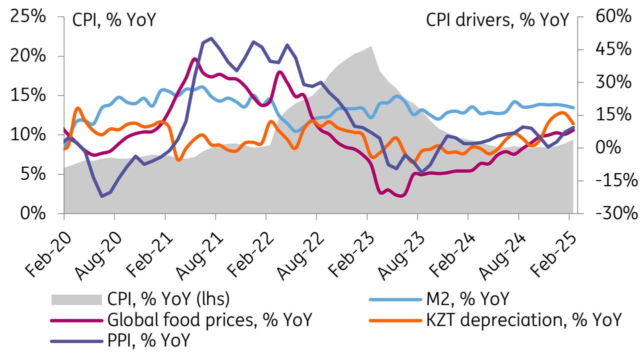
The new official inflation projections correspond to a 14.50-18.00% nominal key rate range by the end of 2025 and 12.00-17.00% by the end of 2026. This suggests very little downside to the base rate in the next two years. We generally agree with the central bank that the inflationary effect of the upcoming VAT hike could start to take place by the end of 2025 due to accelerated consumer demand for durables. At the same time, our relatively constructive view on the tenge (as discussed below) should serve as a disinflationary argument. In our base case, further hikes in the key rate could be avoided, but a first cut is unlikely to take place until 2H26, when the dust from the VAT rate hike settles.

Kazakhstan: Inflation, expectations, and key rate



Source: National sources, CEIC, ING

Kazakhstan: Inflation drivers

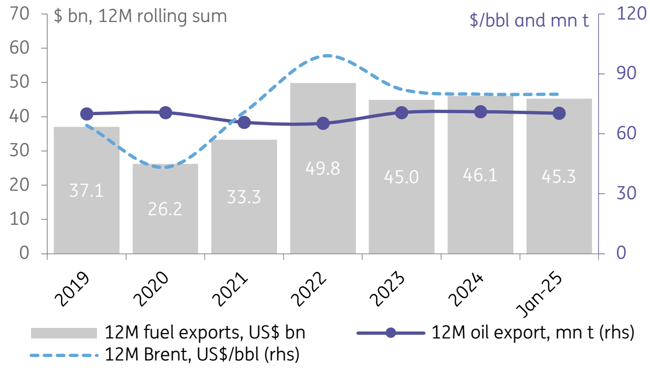


Source: National sources, CEIC, UN FAO, ING

Balance of payments and exchange rate. Following the currency pressure, which in our view was driven purely by the contagion effect from Russia, the Kazakhstani tenge has recovered to c.500/USD, a level last seen at the end of November 2024. The sharp 6-8% swings in the USD/KZT amid USD/RUB's 15% volatility, highlight the sensitivity of the domestic FX market to the geopolitical context. Notably, this is the same 50% sensitivity that was seen in March-April 2022. This suggests that investors should be mindful of procyclical risks of a new round of tenge volatility if Russia or its trade partners face renewed sanction pressure or, in an opposite case, material progress is made towards a hypothetical deal between Russia and Ukraine.

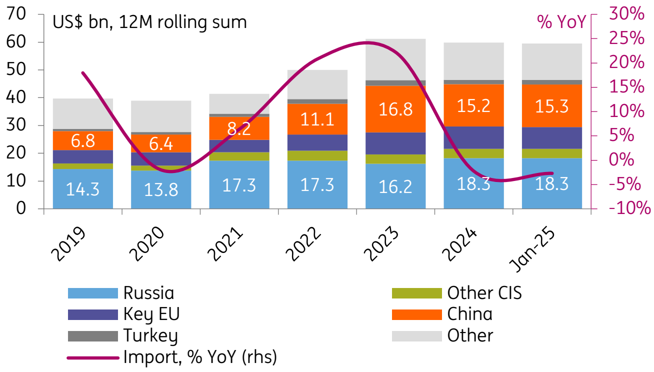
Barring a material change in the geopolitics surrounding Russia, which is not currently in our base case scenario, KZT performance should be based on the balance of payment fundamentals. The trade balance seems to have stabilised at around US$19-20bn surplus pa on both export and import sides. The current account remained in deficit in 2024 due to non-trade items, but the scale of the deficit halved from US$9.0bn in 2023 to just US$4.4bn in 2024, which we take positively. We believe the expected increase in oil exports, which is still planned despite the recent cut in official projections amid flat or modest growth in imports, should allow containment of the current account deficit to within a 1.5-2.5% of GDP range in the coming years.

Kazakhstan: Fuel export volume and value



Source: National sources, CEIC, ING

Kazakhstan: Import growth and geography



Source: National sources, CEIC, ING

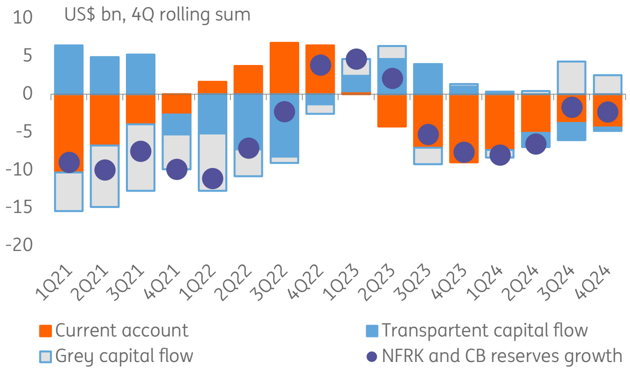
On the capital flow side, we are neutral to slightly positive on private flows, believing that corporate flows will continue to largely balance out the current account, while portfolio flows could be supported by the continued hawkish central bank stance. Meanwhile, as mentioned earlier, the public capital flows, represented mainly by the FX sales of NFRK, the sovereign fund, are usually a more important factor for the tenge in the medium term, putting additional emphasis on the fiscal policy along with the actions of the central bank.

The fiscal framework for 2025 appears supportive for the tenge. Continued transfers from the NFRK on a scale similar to 2023-24, which appears to be the likely case, correspond to around US$10bn annual FX sales conducted for fiscal purposes this year. Moreover, in addition to this, in 2025, the NBRK, the central bank, will sell an additional US$5.5-6.0bn to sterilise its KZT-denominated purchases of gold from domestic producers. Although these sales will be partially offset by FX purchases for the needs of the state pension fund (due to the requirement to maintain a 40% FX share), on net basis, NBRK should be a net seller of FX in 2025, unlike in 2023-24.

Higher state support to the FX market amid stable trade flows keep us constructive on KZT in the near term. Meanwhile, the expected reduction in FX sales from the sovereign fund in 2026 should, in our view, allow the tenge to move closer to its fair value, which we estimate to be in the 550-570 range next year.

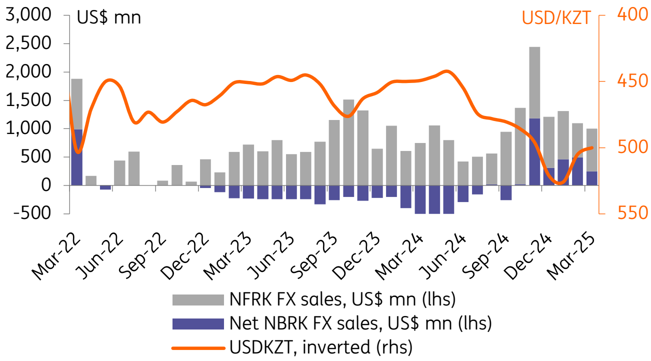
On the positive side, we believe Kazakhstan remains well positioned in the shifting foreign policy landscape, mainly represented by the generally constructive relationship with the US. The recent comments by the US state secretary Rubio on potential repeal of the Jackson-Vanik amendment and a desire to deepen bilateral economic ties in the energy sectors suggest that a shift in the US rhetoric surrounding the Russia-Ukraine conflict, the rise of global defence spending and the increased global trade tensions could be more of an opportunity for Kazakhstan rather than risk.

Kazakhstan: Balance of payment composition



Source: National sources, CEIC, ING

Kazakhstan: NBRK/NFRK FX sales and KZT



Source: National sources, CEIC, ING

Credit strategy

Some improvements in the external picture are balanced by modest fiscal weakening, leaving fundamentals overall fairly stable, while some fiscal consolidation is expected towards 2026. Last year saw a rating upgrade by Moody's, with all outlooks now stable and a composite rating of BBB, ranging across this tier (Baa1/BBB/BBB-). We expect no further changes this year, while more new issuance is likely given the $2.5bn maturity in July.

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

Agency	Upgrade factors	Downgrade factors
Moody's Baa1 (STABLE)	• Further reforms to strengthen institutional framework and policy credibility. • Accelerated process of economic diversification, to expand growth drivers.	• A structural fall in oil production or exports, perhaps driven by acceleration of in global carbon transition. • Crystallisation of domestic political risks, such as a re-emergence of social unrest, and external geopolitics, sanctions. • Slowdown in domestic reform momentum.
S&P BBB- (STABLE)	• Medium-term fiscal trajectory improves quicker than expected, reducing the pace of debt accumulation. • 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, which could worsen external position and fiscal deficits. • Rising borrowing costs increase the government debt servicing burden. • Deteriorating domestic stability with severe civil unrest.
Fitch BBB (STABLE)	• **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

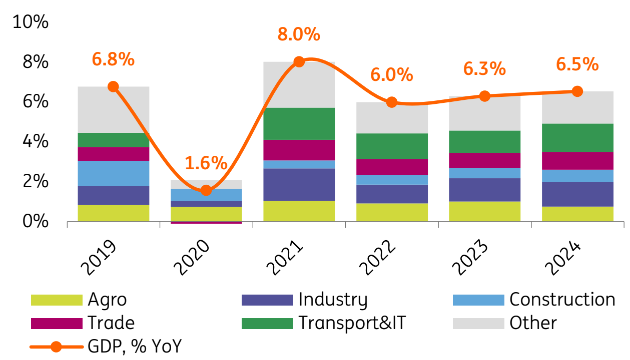
Economic overview

After showing strong 6.0-6.5% of GDP growth over the past three years, Uzbekistan could be heading into a slowdown in activity due to a shift to fiscal consolidation, limited room for monetary easing on the back of elevated inflationary risks and slowing credit growth. Meanwhile, the changing global trade environment and geopolitical environment could create additional growth opportunities for Uzbekistan as a commodity exporter, especially of gold. The CBRU increased its reserves by 400,000oz of gold in 2024 and may consider 2025 as a good opportunity to sell.

Economic activity. Uzbekistan's GDP posted a slight acceleration from 6.3% in 2023 to 6.5% in 2024 as a weakening in the agricultural output was offset by stronger activity in the transportation, construction and industrial sectors, reflecting Uzbekistan's continued focus on capex-driven growth and active participation in the regional trade and financial flows. Consumption-focused sectors, though also robust, showed a more moderate contribution to growth, as households faced increased pressure from liberalised domestic tariffs, and retail lending growth slowed from 47% in 2023 to just 19% in 2024.

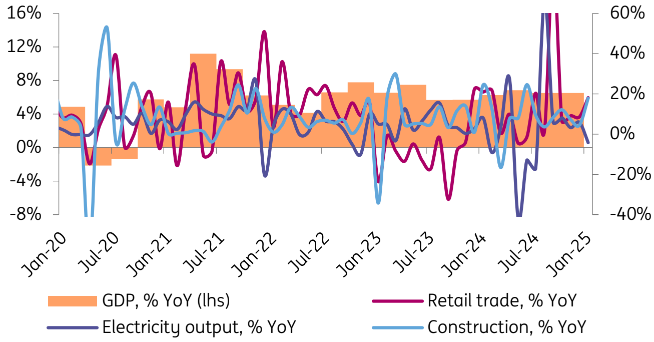
Further growth trends appear mixed. On the one hand, the still rapid retail deposit growth of 31% YoY in 2024 suggests that households have the resources to finance consumption. Also, Uzbekistan's position as a commodities exporter should add some resilience in the face of global trade wars and higher defence spending. On the other hand, a further upcoming hike in domestic tariffs should put additional pressure on households, while corporates may face some headwinds from fiscal consolidation. We see GDP growth moderating to 5.5-6.0% in the next couple of years.

Uzbekistan: GDP growth composition



Source: National sources, CEIC, ING

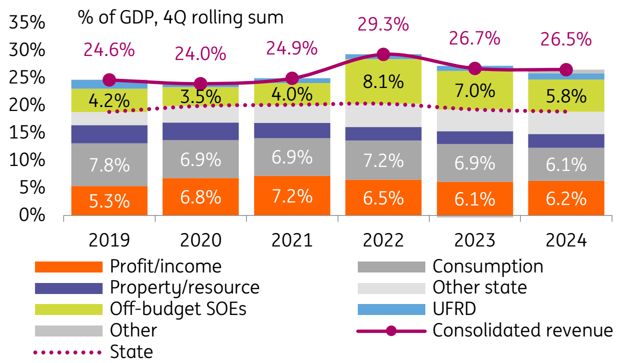
Uzbekistan: Key activity indicators



Source: National sources, CEIC, ING

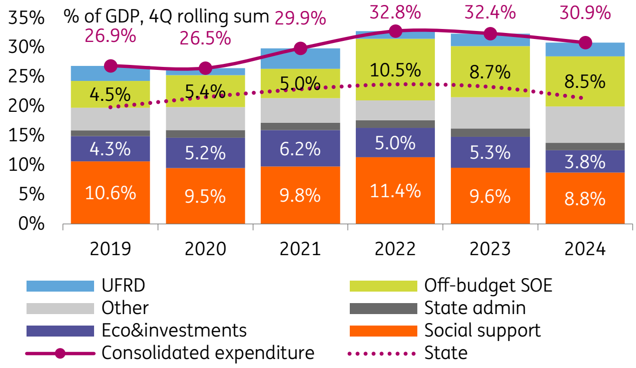
Fiscal policy. While we previously expressed concern in relation to the widening of the consolidated budget deficit to around 6% of GDP in 2023 and some further easing at the beginning of 2024, it now appears that the government is taking some steps to address the accumulated fiscal imbalance. According to Finance Ministry data, given a continued but modest 0.2ppt decline in the consolidated revenues to 26.5% of GDP in 2024, the government managed to reduce spending by a noticeable 1.5ppt to 30.9% of GDP. This was achieved through restraint on investment and social spending, mainly at the central government level, after a spending splurge in the previous couple of years. This stringency led to a decline in the consolidated budget deficit by 1.3ppt to 4.3% of GDP against a sharper reduction from 4.1% to 2.5% of GDP at the central government level.

Uzbekistan: Consolidated budget revenue



Source: National sources, IMF, CEIC, ING

Uzbekistan: Consolidated budget spending

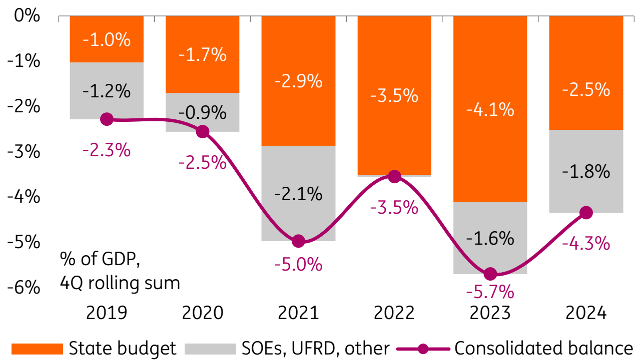


Source: National sources, IMF, CEIC, ING

The budget law for 2025 guides for a further 1.3ppt reduction in the consolidated deficit to 3% of GDP, including a 0.5ppt reduction at the central government level to 2.0% of GDP. This is expected to be achieved through a more targeted approach to household subsidies and other ways of social support, as well as more restraint on the capital spending side. While we believe the government will be able to continue fiscal consolidation, there is a risk that the scale of it could be more modest than officially guided due to a changing macro environment. One example is that the official CPI assumption for this year is 7% which may prove 1-2ppt too optimistic and may require additional social spending. We see the consolidated budget deficit narrowing modestly to 3.5-4.0% of GDP this year, which however is tighter than our previous assumptions.

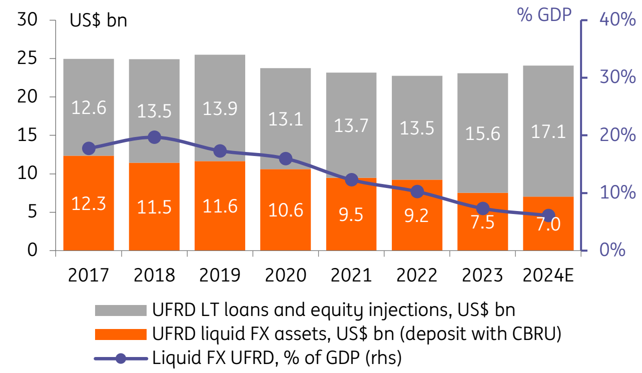
The consolidation drive should lower the pressure on state savings, as the liquid portion of the state sovereign fund UFRD, according to our estimates, declined to US$7bn, or 6% of GDP in 2024. The budget law for 2025 allows for international borrowing of up to US$5.5bn (c.4% of GDP), including US$3.0bn to finance the central government deficit.

Uzbekistan: Consolidated budget balance



Source: National sources, IMF, CEIC, ING

Uzbekistan: Sovereign fund composition

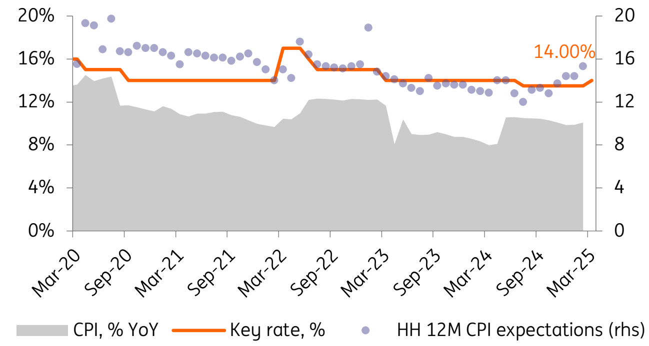


Source: National sources, IMF, Fitch, CEIC, ING

Inflation and monetary policy. Although Uzbekistan weathered the first round of the increase in regulated tariffs in May 2024 relatively well, inflation has remained elevated at around 10% YoY since then, which is far from the long-term target of 5%. In addition, the upcoming second round of tariff hikes due this April could add a further 1-2ppt to the CPI, firing up households' inflationary expectations and challenging the official year-end CPI projection of 7-8%. As a result, CBRU, the central bank, made a hawkish decision in March 2025 to raise the key rate by 50 basis points to 14.00%. While the primary drivers of the decision seem to be domestic, we note that the simultaneous tightening in the monetary policy stance by Uzbekistan, Armenia (which opted to hold the rate instead of cutting) and Kazakhstan in March 2025 could also reflect a collective reassessment of the inflation and capital outflow risks stemming from the shifting global macro environment.

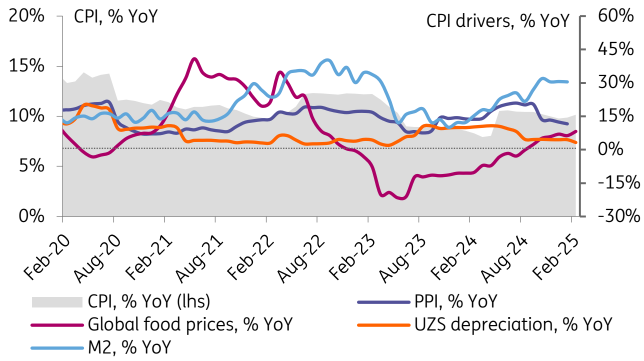
We believe the inflationary effect of the upcoming tariff hikes in Uzbekistan will be limited and still see a possibility of disinflation in 2H25 on tighter fiscal policy, sluggish credit growth and the high statistics base effect of 2024. Meanwhile, growing global inflationary pressures mainly from higher food prices as well as structural issues of the domestic economy remain pro-inflationary risk factors. We see a risk of CPI ending the year 1-2ppt higher than the official target, which limits room for the policy rate cut for this year at around 50 basis points, in our view.

Uzbekistan: Inflation, expectations, and key rate



Source: National sources, CEIC, ING

Uzbekistan: Inflation drivers

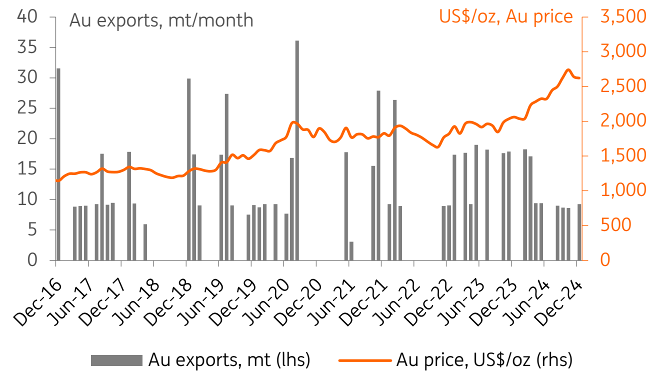


Source: National sources, CEIC, UN FAO, ING

Balance of payments and exchange rate. In line with our expectations, the pace of UZS depreciation to USD slowed from 9% in 2023 to just 4% in 2024. Meanwhile, the second half of the year was more challenging for the soum, and we attribute it to a decline in the gold selling activity of UFRD, the country's central bank and the sole exporter of gold. According to customs data, gold exports dropped from 54.2 metric tons in 1H24 to 35.5 tons in 2H24, which may reflect CBRU's desire to replenish the gold reserves it spent in 2023 and an attempt catch the peak gold prices, which is in line with CBRU's historical behaviour during gold price rallies.

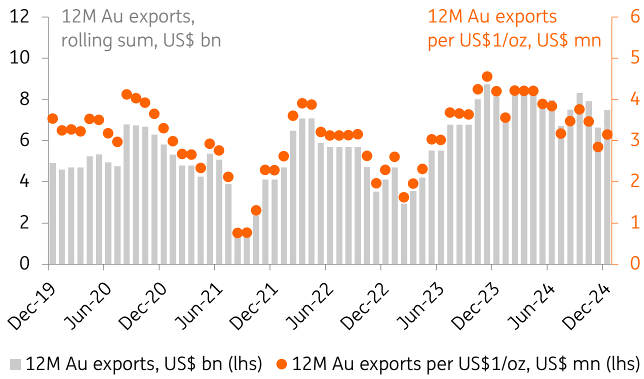
As a result of the restrained gold sales, the country's annual gold export proceeds dropped from an elevated US$4.2m per US$1/oz of gold price in 2023 to US$3.1m in 2024. Meanwhile, having accumulated around 12mt of gold in 2024, CBRU entered 2025 with 350mt in reserves, which is 3.5 times the annual domestic production. In our view, this leaves some room for Uzbekistan to boost gold exports if it wants to benefit from the continued global growth in the appetite for gold.

Uzbekistan: CBRU monthly gold exports



Source: National sources, CEIC, media, Statista, ING

Uzbekistan: Export sensitivity to gold price

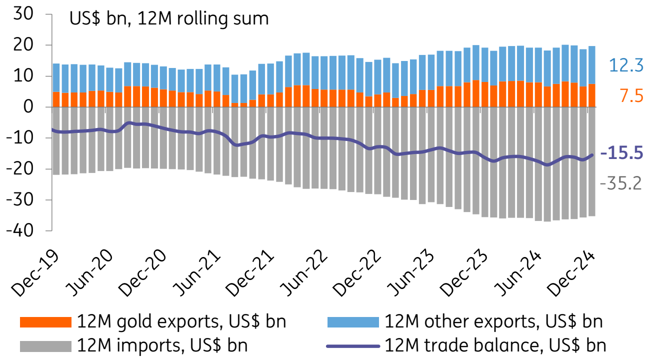


Source: National sources, CEIC, ING

Outside of the gold segment, Uzbekistan's trade balance conditions are largely benign. Non-gold exports were supported in 2024 by the strong pricing environment, especially for uranium, but also to some extent for copper. Meanwhile, import growth decelerated in 2H24 and even contracted by 1% for the full year, possibly reflecting moderation in the appetite for capex amid a more stringent fiscal approach, which is also suggested by a decline in the trade deficit with China for the first time in several years. The increase in the trade deficit with Russia mirrored by an increased trade surplus with smaller partners may point to a higher participation in regional Russia-related trade, but the overall effect on the balance of payments should be largely neutral.

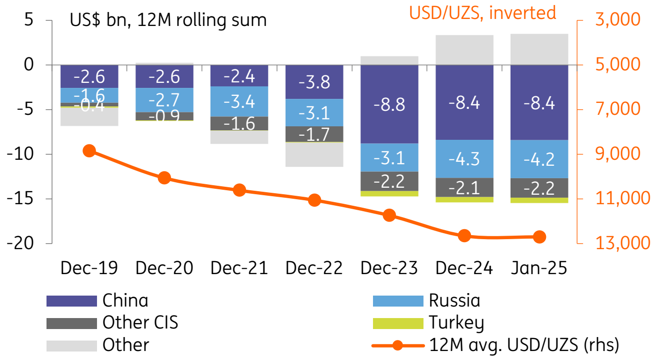
Sensitivity to ruble movements is quite low and is noticeable only during shocks. For example, UZS broke its usual depreciation streak and appreciated by 0.6% to USD in February while the ruble saw a 12% recovery vs USD. In November 2024, the currencies showed movements of a similar scale in the other direction. This suggests a c.5% sensitivity, which is ten times weaker than the link between KZT and RUB at times of heightened currency volatility. Trade relations with China, Uzbekistan's made trade partner, should be more in focus, especially in the context of global trade wars.

Uzbekistan: Trade balance composition



Source: National sources, CEIC, ING

Uzbekistan: Balance of trade and services vs UZS



Source: National sources, CEIC, ING

Overall, we continue to see 3-5% UZS depreciation to USD on a medium-term horizon, which would be necessary for the country's external balance in the context of elevated domestic inflation and the standard twin deficit mode. A potential ramp up in the export of gold and other commodities in the current environment represents an upside risk, while a negative consequence of the global trade wars for China should be seen as a downside scenario for Uzbekistan.

Credit strategy

In terms of fundamentals, Uzbekistan's strong balance sheet (low government debt and strong reserve coverage) is slightly weakened by twin deficits, although the sovereign remains in a comfortable position. Signs of steps towards fiscal consolidation are a positive factor, while new USD500mn and EUR500mn deals in February mean further issuance this year is unlikely, improving the technical picture. This leaves us with a favourable outlook.

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

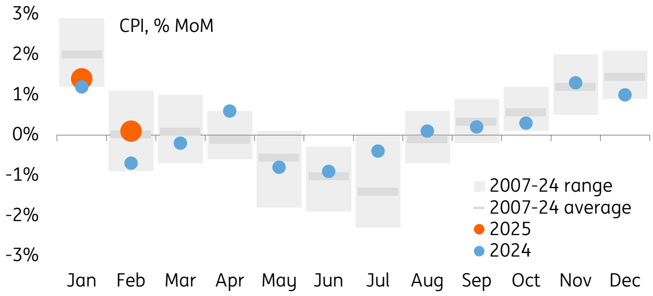
Agency	Upgrade factors	Downgrade factors
Moody's Ba3 (STABLE)	• Further progress in structural reforms to improve competitiveness. • Deepening of domestic capital markets to reduce reliance on foreign currency debt.	• Permanent weakening in real GDP growth and worse fiscal metrics. • Persistent widening in current account deficits without increased foreign investment. • Domestic political instability hinders the pace of reforms.
S&P BB- (STABLE)	• 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. • External and public debt continue to increase rapidly. • Weaker financial performance of SOEs leads to the transfer of contingent liabilities to the government balance sheet.
Fitch BB- (STABLE)	• **Fiscal:** Consolidation that enhances medium-term debt sustainability. • **Macro:** Structural reforms that boost GDP growth prospects. • **Structural:** Improvement in governance standards and easing in geopolitical risk.	• **Fiscal:** Marked rise in government debt due to period of low growth, loose fiscal stance, sharp UZS depreciation, 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 1

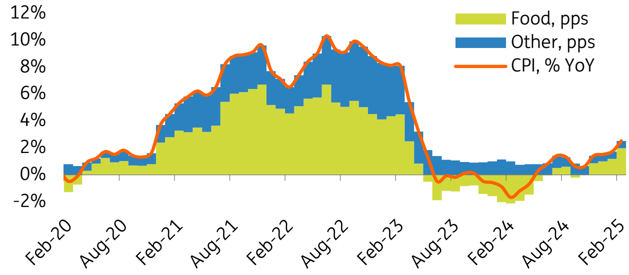
CIS-4 Inflation: Seasonality and composition

Armenia: Monthly price growth seasonality



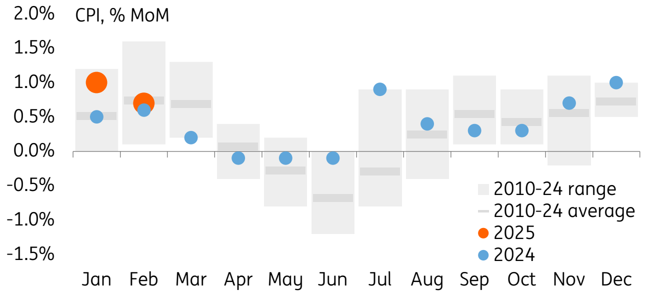
Source: National sources, CEIC, ING

Armenia: Annual CPI growth composition



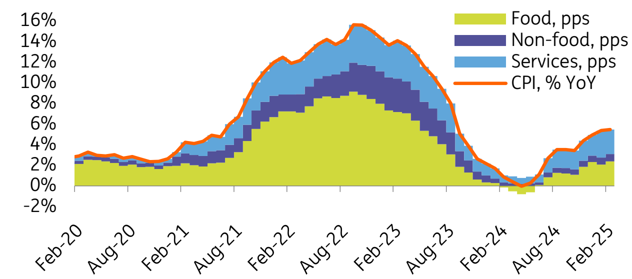
Source: National sources, CEIC, ING

Azerbaijan: Monthly price growth seasonality



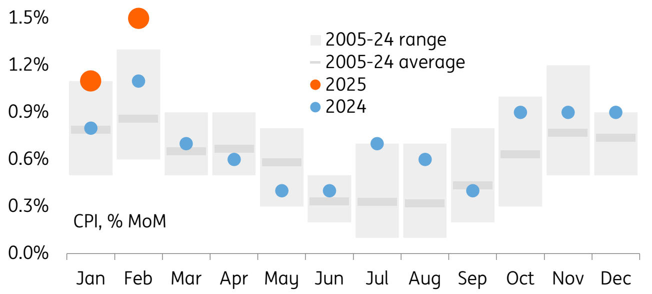
Source: National sources, CEIC, ING

Azerbaijan: Annual CPI growth composition



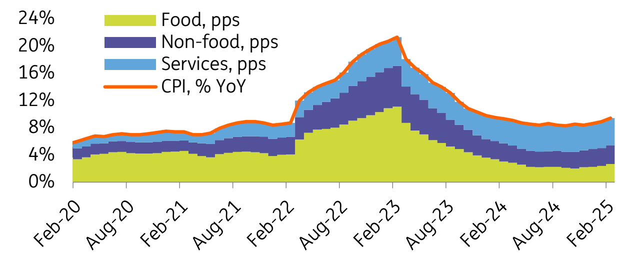
Source: National sources, CEIC, ING

Kazakhstan: Monthly price growth seasonality



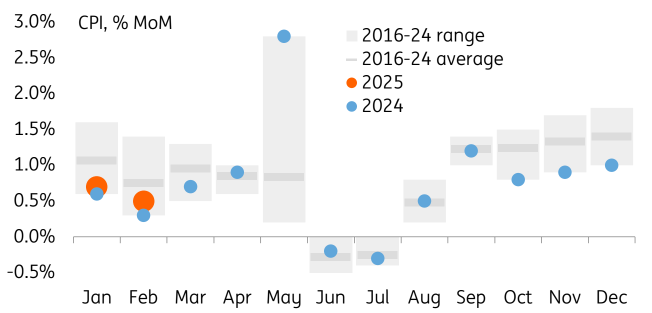
Source: National sources, CEIC, ING

Kazakhstan: Annual CPI growth composition



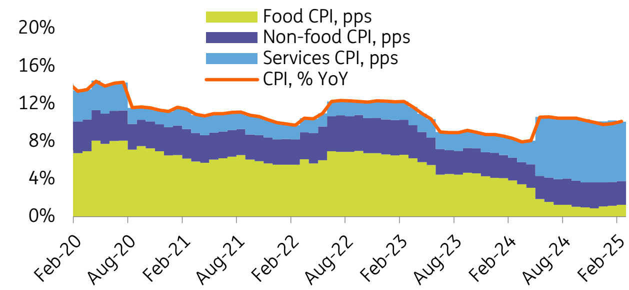
Source: National sources, CEIC, ING

Uzbekistan: Monthly price growth seasonality



Source: National sources, CEIC, ING

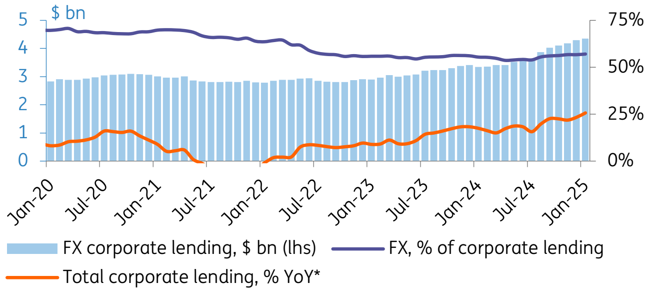
Uzbekistan: Annual CPI growth composition



Source: National sources, CEIC, ING

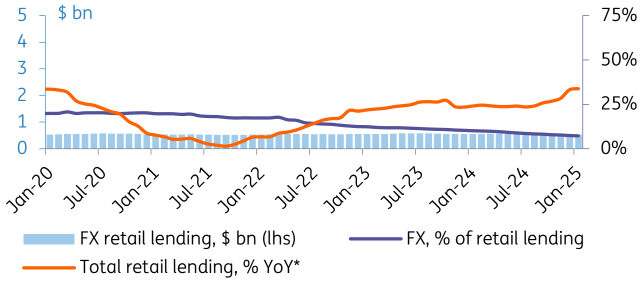
Appendix 2
CIS-4 banking sector lending trends

Armenia: Corporate lending (30% of GDP)



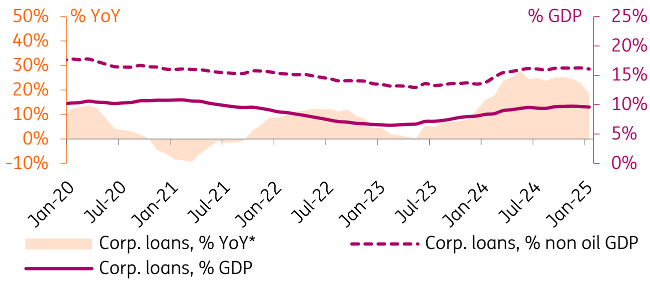
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Armenia: Retail lending (29% of GDP)



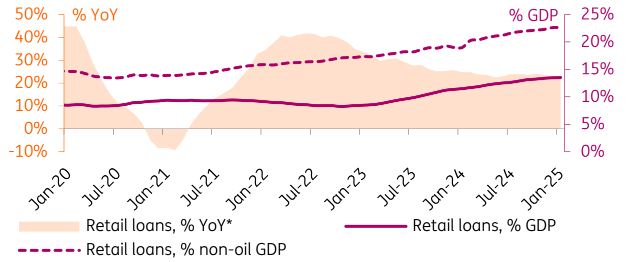
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Azerbaijan: Corporate lending (10% of GDP)



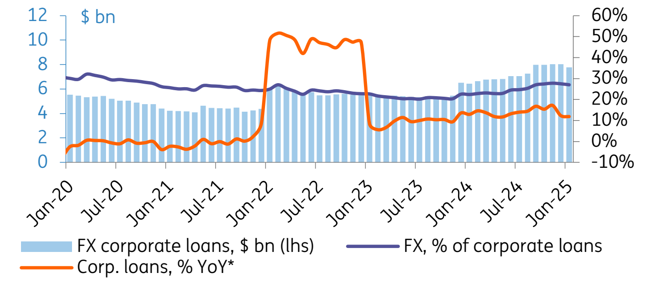
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Azerbaijan: Retail lending (14% of GDP)



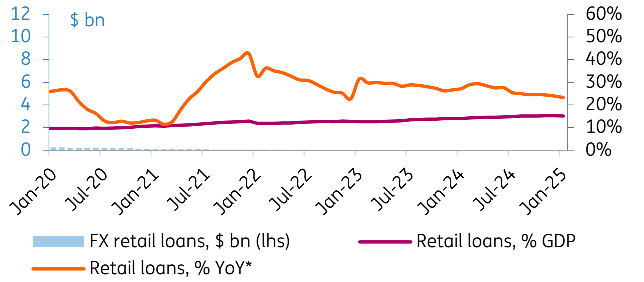
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Kazakhstan: Corporate lending (11% of GDP)



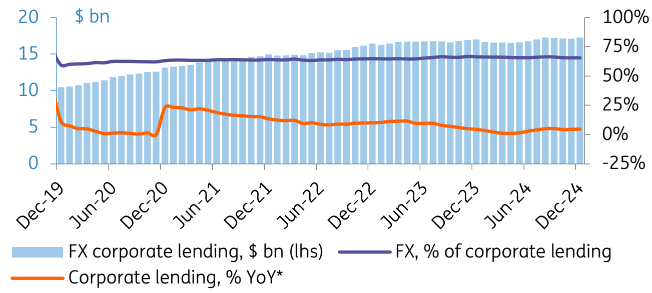
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Kazakhstan: Retail lending (15% of GDP)



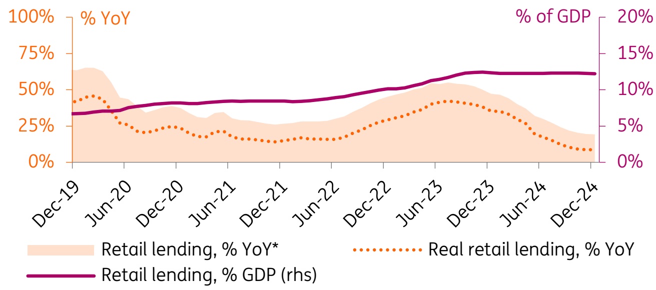
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Uzbekistan: Corporate lending (23% of GDP)



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

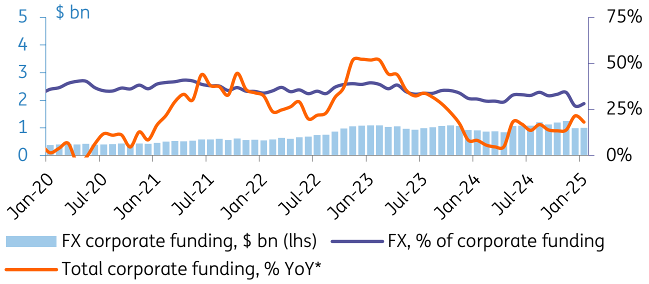
Uzbekistan: Retail lending (12% of GDP)



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

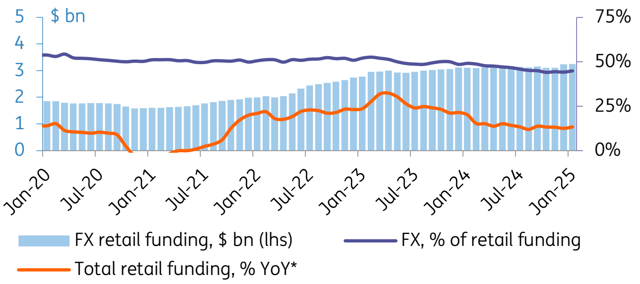
Appendix 3
CIS-4 banking sector funding trends

Armenia: Corporate funding (14% of GDP)



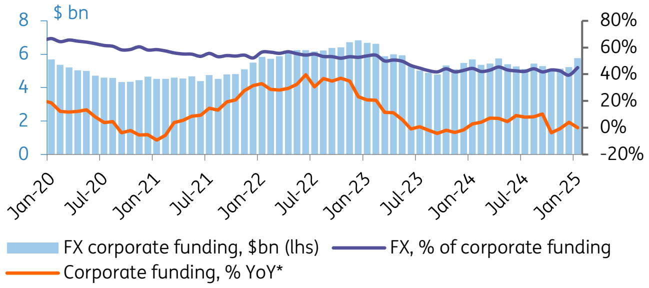
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Armenia: Retail funding (28% of GDP)



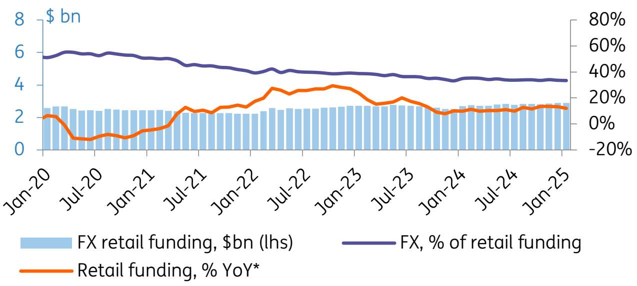
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Azerbaijan: Corporate funding (17% of GDP)



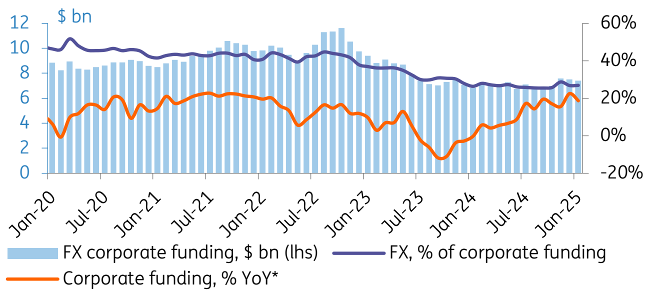
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Azerbaijan: Retail funding (12% of GDP)



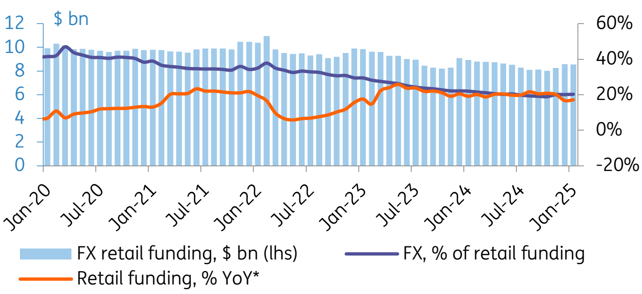
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Kazakhstan: Corporate funding (13% of GDP)



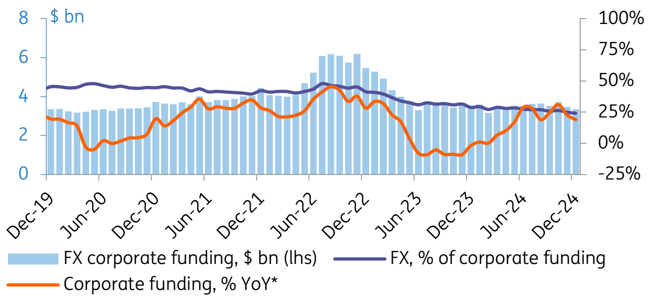
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Kazakhstan: Retail funding (19% of GDP)



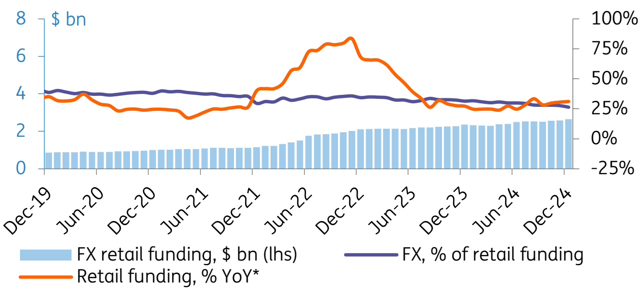
*Adjusted for FX revaluation effect
Source: National sources, CEIC, ING

Uzbekistan: Corporate funding (12% of GDP)



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

Uzbekistan: Retail funding (9% of GDP)



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

Disclaimer