UZBEKISTAN: WE DO NOT EXPECT A SHIFT TO MONETARY EASING

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At its first meeting this year on Thursday, January 26, we expect the Central Bank of the Republic of Uzbekistan (CBRU) to keep the base rate unchanged at 15% in order to ensure a disinflationary effect and cool down inflationary expectations. Such a decision would be in line with signals provided by the CBRU in December, indicating a need in moderately tight monetary conditions in 2023 in order to bring inflation down to target levels. We believe that this approach would also help maintain the attractiveness of UZS-denominated assets. Given ongoing strong growth in food prices and likely inflationary pressure in the service segment, we expect the tone of the press release to remain neutral.

Key factors suggest that the base rate will remain unchanged

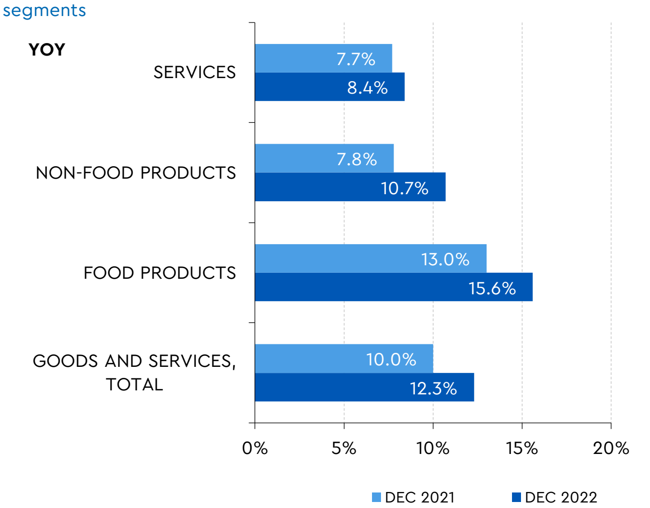
At its final meeting in 2022, the CBRU kept the base rate unchanged at 15%, in line with our and market expectations. Uzbekistan's Central Bank noted that, despite stabilization of global prices for key products and energy goods, inflationary pressure persists in the local economy.

At its December meeting, the CBRU also noted that heightened inflationary expectations among the population over the past 3-4 months and the uptrend in core inflation required maintenance of moderately tight monetary conditions. We note that the current level of the real rate (2.7%) is helping to maintain the attractiveness of UZS deposits and prevent growth in dollarization, which could exert pressure on Uzbekistan's sovereign ratings. Thus, we believe that the current level of the rate is comfortable for the CBRU and will help ensure deceleration of inflation to projected levels. Assuming the persistence of current moderately tight monetary conditions, we estimate that inflation may decelerate to 9.5% YoY by year end.

In our view, a decision to keep the rate unchanged at 15% will also be supported by the following factors:

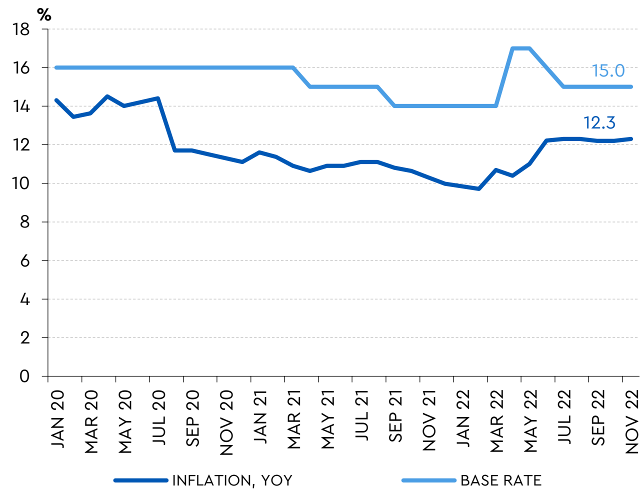
- **Inflation stabilized at November's level but inflationary pressure remains strong in all segments.** CPI in December slightly exceeded our 12% YoY forecast and stabilized at the level seen in November. This was due to slower growth in food prices and their stabilization in the non-food segment. That said, growth of food prices remains high and inflationary pressure in the service segment has been strengthening. We do not exclude that this was driven by an inflow of tourists.

Chart 1. Inflationary pressure remains elevated in the food and non-food segments



Source: Statistics Committee of Uzbekistan

Chart 2. Uzbekistan's real rate remains high



Source: CBRU, Statistics Committee of Uzbekistan

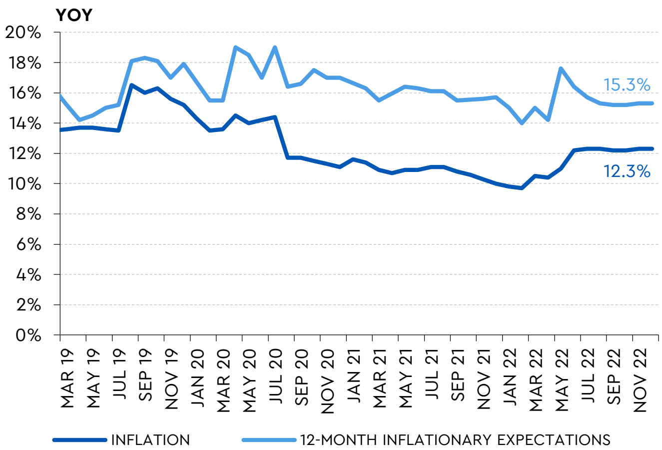
Heightened inflationary risks in the food segment persist. Growth in food prices slowed to 15.6% YoY, down by 0.4 pps compared with November amid a slower increase in prices for wheat flour to 44.5% YoY (-2.3 pps) and sugar to 43.6% YoY (-6.2 pps). That said, the pace of growth in prices for other key food products, including rice, meat and dairy products, remains high.

Non-food price growth stabilized at the level seen in October-November (+10.7% YoY) thanks to a slowing of growth in prices for clothing and footwear to 9.4% YoY (-0.3 pps vs. November).

Growth in service tariffs continued to accelerate in December, reaching 8.4% YoY (+0.6 pps vs. November). We believe that this was facilitated by heightened demand among foreign tourists for travel to Uzbekistan. In particular, we are seeing high growth rates in housing rent (+24.6% YoY, +0.6 pps vs. November) and catering & hospitality services (+23.6%, +3.1 pps).

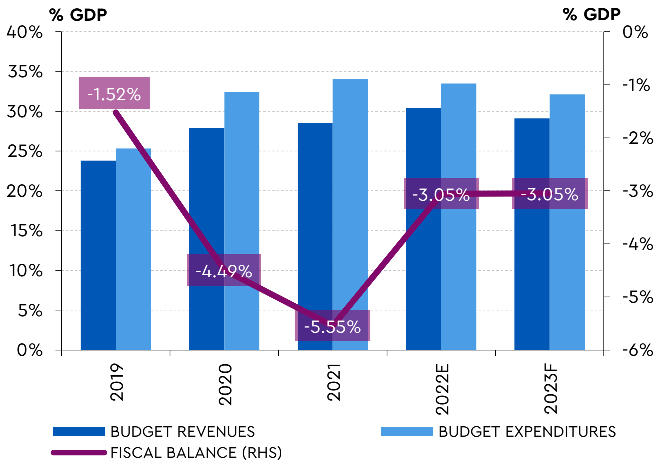
- **Inflationary expectations have stabilized but remain high.** According to the latest CBRU data, inflationary expectations, despite having decreased from their local peak recorded last May, still stood at 15.3% YoY at end December among households (+0.1 pps vs. the October survey) and 14.3% YoY among businesses (+0.5 pps), or 300 bps and 200 bps above actual inflation, respectively. We believe that high inflationary expectations continue to be fueled by accelerated rates of growth in food prices and service tariffs.
- **Fiscal stimulus will continue to support the economy.** Despite the planned maintenance of the consolidated budget deficit this year at a level comparable with 2021 (3.1% of GDP), fiscal policy will remain stimulatory. At its previous meetings, the CBRU noted that fiscal stimulus will be one of key factors supporting consumer demand and investment activity under moderately tight monetary conditions. On the other hand, the country's central bank considers soft fiscal policy to be one of the main inflationary factors. It should be noted that the CBRU continues to actively sterilize excess liquidity while conducting stimulatory budget policy: in 2022, volumes at deposit auctions increased significantly, totaling UZS 122.3 trln (3.1x the amount in 2021).

Chart 3. Inflationary expectations remain elevated



Source: Statistics Committee of Uzbekistan, CBRU

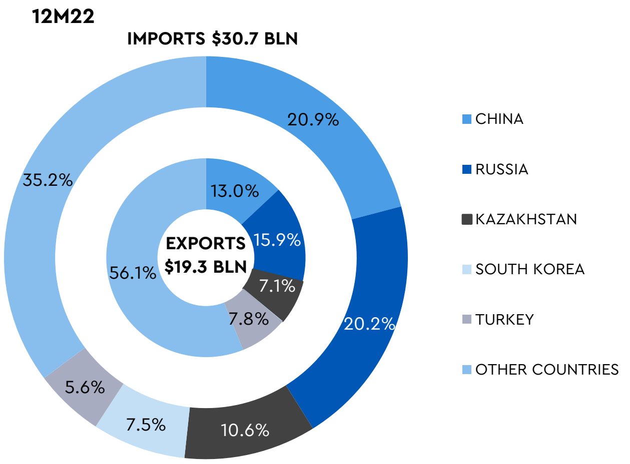
Chart 4. Budget deficit is set to stabilize in 2023 but fiscal policy will remain stimulatory



Source: Finance Ministry of Uzbekistan, Gazprombank estimates

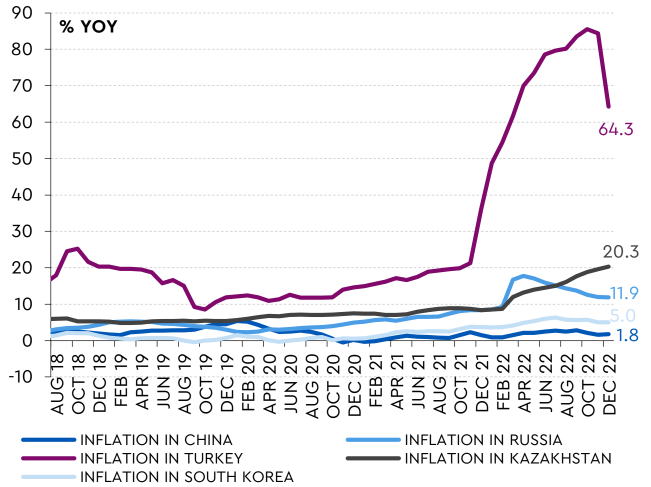
- **Inflationary pressure from Uzbekistan's key trade partners remains in place.** The leading exporters to Uzbekistan – Russia and China – accounted for a combined 41.1% of imports in 2022. Inflation in Russia decelerated to 11.9% YoY in December (-0.1 pps compared with November) but is still running at a double-digit pace. Growth of consumer prices in China reverted upward following the lifting of COVID-related restrictions. In December, inflation accelerated to 1.8% YoY (+0.2 pps compared with November). We also note that inflationary pressure remains in place in Kazakhstan and Turkey, which together accounted for another 16.2% of Uzbek imports. Inflation in Turkey decelerated to 64.3% YoY from historical highs amid exhaustion of the high-base effect, but still remains high. Inflation in Kazakhstan continued to accelerate in December and exceeded 20% YoY. Thus, risks to Uzbekistan from more expensive imports remain in place.

Chart 5. Key countries exporting to Uzbekistan



Source: Statistics Committee of Uzbekistan

Chart 6. Inflation in key exporters to Uzbekistan



Source: statistics committees of China, Russia, Turkey, Kazakhstan and South Korea

Given the CBRU's cautious signals at its December meeting alongside persistent inflationary pressure in food prices and services amid still elevated inflationary expectations, we expect the Central Bank to keep the base rate unchanged on Thursday in order to ensure a disinflationary effect. In addition, given sustained high inflationary risks, we do not expect the CBRU to soften its rhetoric. The tone of the press release will likely remain neutral and contain no indication of a rate cut at upcoming meetings.

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