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ARMENIA AZERBAIJAN

CIS-4: Who's afraid of higher core rates?

Our base case for the regional rates and currencies remains constructive and domestically-driven. But resilience to more persistent global inflation and higher core rates could be put to the test through the exchange rate channel. While we don't expect a sell-off, high real rates will be required to keep attracting portfolio inflows



Higher oil prices are strengthening Azerbaijan's economic buffers

Base is bliss: selectively dovish and FX-constructive

Since the outbreak of Middle East tensions, the CIS-4 has weathered higher volatility, rising global inflation expectations and tighter core rates, easing some of our initial concerns. A gradual deterioration in ING's global base case, or stabilisation, should therefore be broadly neutral for the regional outlook. Higher energy and freight costs lift imported inflation, but CIS-4 currencies, so far resilient to tighter global rates, should keep policy responses country-specific.

Kazakhstan and **Uzbekistan** still have room for cautious monetary easing as inflation falls from high bases and strong currencies dampen external cost pressures. The tenge has strengthened 11% since the Iran war began, supported by capital inflows, while the backlog of

state FX sales provides a medium-term cushion. The soum has gained 2% and should benefit from a catch-up in gold exports, supporting FX in the medium term.

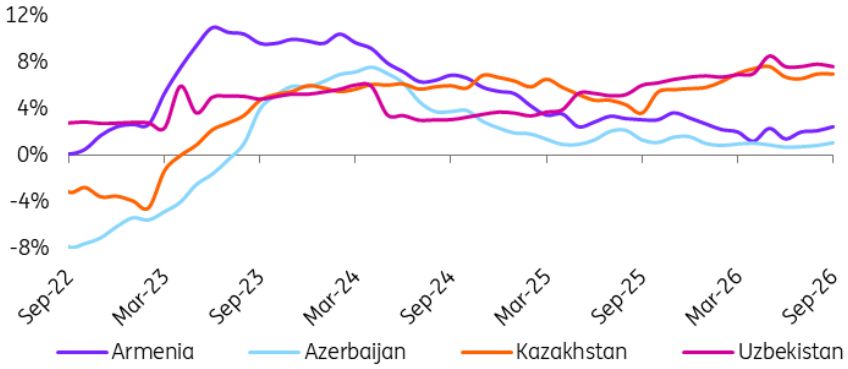
Kazakhstan's inflation has slowed 3ppt this year to 9.3% year-on-year, allowing the National Bank of Kazakhstan to cut the base rate from 18.00% to 16.25%. Uzbekistan's inflation fell almost 1ppt to 6.4%, while its policy rate remains at 14.00%. Meanwhile, inflation remains above both 5% targets, which, combined with domestic demand-side pressures, limits further cuts to 1.0-1.5ppt up to the end of 2027.

Azerbaijan is more stable: higher oil prices reinforce its buffers, while the manat peg limits imported inflation. With CPI within the 4±2% target range, we expect the policy rate to stay at 6.50%.

Armenia remains the hawkish outlier. Tourism and remittance-supported demand has lifted inflation 1ppt this year to 4.3% YoY, above the 3% target. September's 25bp hike to 6.75% appears precautionary, but inflation approaching 5% could warrant another small move.

Kazakhstan and Uzbekistan retain relatively high real rates

Real policy rates in CIS-4 (%), based on CPI over the past 12 months



Source: National sources, CEIC, Refinitiv, ING

Persistent global inflation and higher core rates would put CIS resilience to the test

As the global context this year has a poor track record in fulfilling the base case or optimistic expectations, an alternative and more challenging scenario should be considered. A further spike in commodity prices, which would bring stronger inflation and materially higher core rates, would likely put CIS resilience to a test, with CIS macro sensitivities back in focus.

Higher energy prices. Each additional $10/bbl could lift annual exports by 2-4% of GDP in Azerbaijan and Kazakhstan, although the FX effect is constrained by Azerbaijan's peg and

Kazakhstan's export volumes and dividend-outflow dynamics. For Armenia and Uzbekistan, it would add around 0.5% of GDP to import costs.

Imported inflation. Global food prices are already 6% higher YoY. We estimate that each 10% increase could add around 1ppt to the inflation trend in Kazakhstan and Uzbekistan and 1.5-2.0ppt in Armenia and Azerbaijan. Broader exposure to imports from developed markets and the Middle East ranges from 26% in Armenia and 35% in Kazakhstan and Uzbekistan to around 45% in Azerbaijan.

Higher core yields would weaken carry-driven support for the tenge and soum, reducing their insulation from imported inflation. But domestic buffers argue against an indiscriminate sell-off: Kazakhstan has high real rates and a backlog of state FX sales; Uzbekistan will be catching up on delayed gold exports; Armenia can fall back on its remittance inflows and comfortable reserves; and Azerbaijan can rely on its exceptional sovereign assets.

In an adverse global scenario, we therefore see 1-2 ppt upside risk to our medium-term inflation outlook. The cost-driven nature of the shock may not require an immediate policy response, but central banks may need to protect real rates: Armenia could tighten further, Kazakhstan and Uzbekistan have less room to cut, and Azerbaijan's reluctance to hike could be challenged.

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