MACRO UPDATE – UZBEKISTAN

The UZS: How Exaggerated to Call it a Safe Haven?

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KEY TAKEAWAYS

- In a world where the USD has begun displaying emerging market characteristics, could an EM currency – such as the UZS – serve as a sort of a safe haven?
- The Middle East escalation has prompted requests of a review of our UZS outlook, which we maintain broadly unchanged – lower UZS rates and at least lower depreciation going forward;
- In fact, the current events demonstrate how exactly the structural resilience of the Uzbekistan economy works in practice;
- Overall, based on our judgement, the impact on economic growth is expected to be limited, while inflation is set to rise amid a surge in oil prices – as of now, still expected to be temporary;
- Regarding structural drivers, underlying disinflation has continued, market interest rates have declined, the yield curve has inverted – in line with our forecasts, and the external balance sheet has kept improving;
- Overall, we believe that the UZS risk-adjusted return is certainly very impressive and the market has still not fully priced this in, just like two years ago, when we argued against the then consensus view of locking in the UZS long end.

It is a strange world where the USD has begun displaying emerging market currency characteristics, and markets have been scrambling in search of safe haven assets, but these are no ordinary times indeed. Could the opposite also be true, and an EM currency – such as the UZS – serve as a sort of a safe haven? Perhaps, it is not entirely inconceivable to suggest so.

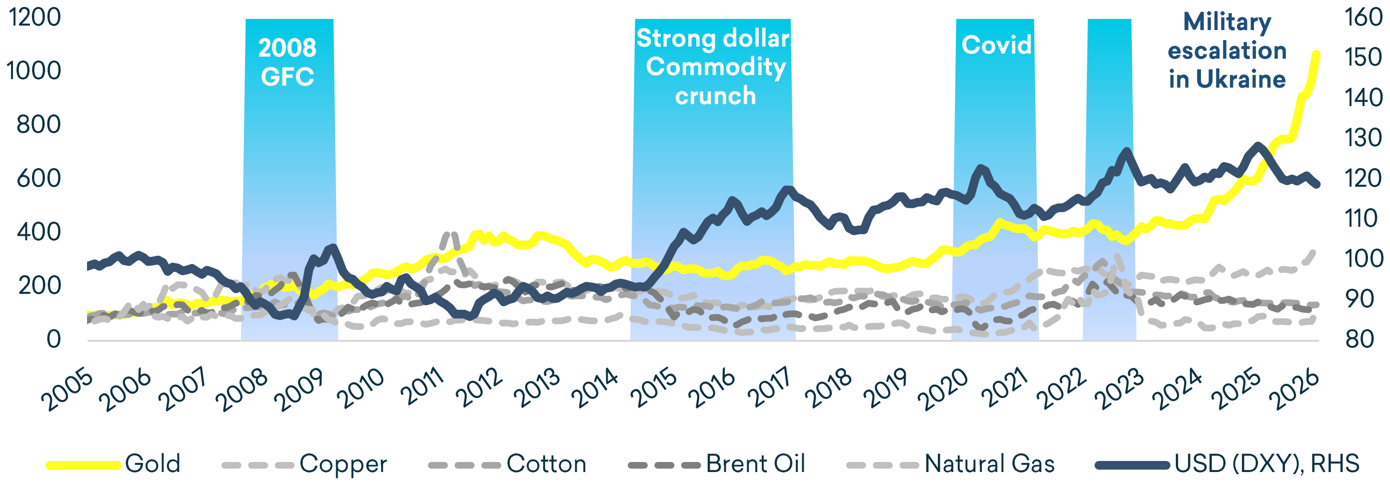
We've been meaning to publish an update on our Uzbekistan projections for some time, with the intention of grouping together follow-up questions from readers – like we did for Georgia last month. With the Middle East escalation prompting a fresh round of enquiries – somewhat surprisingly, or, maybe, for a reason, even exceeding questions received on Georgia – and the initial impact assessment on Georgia already out of the way, now's the time.

At the risk of sounding slightly self-congratulatory, one could argue that there has not been all that much to revise – developments have, by and large, been in line with forecasts from our October 2024 flagship note, where we laid out the case for locking in the UZS long end, following up later with even more evidence in June 2025. That said, the Middle East escalation certainly is a significant – albeit hopefully temporary – external shock, so it is an appropriate moment to revisit our projections and ask whether recent events warrant a change in the outlook.

To save the suspense, the answer is yes – our judgement stands: lower UZS rates and at least lower depreciation of the currency going forward, as we have consistently argued. In fact, the current events demonstrate how exactly the structural resilience of the Uzbekistan economy works in practice. Of course, no economy is insulated from geopolitical shocks. But the countercyclical features we have highlighted, together with medium-term drivers – underlying disinflation, credit normalization, and the external balance sheet improvement – remain in place, supporting the UZS alongside higher gold prices.

What do we mean by this structural resilience? TBC Capital readers are well aware, as we have emphasized repeatedly, that Uzbek exports are dominated by gold, industrial metals – mainly copper – as well as gas, cotton, textiles, and fruits and vegetables. Demand for cyclical metals and energy typically strengthens during periods of robust global growth. Gold prices, meanwhile, tend to rise during global downturns or periods of stress (Figure 1) – as is happening now, even if some of the initial gains have been scaled back in recent days.

FIGURE 1: PRICES OF PRO-CYCLICAL COMMODITIES AND GOLD ARE USUALLY INVERSELY CORRELATED, BOOSTING RESILIENCE

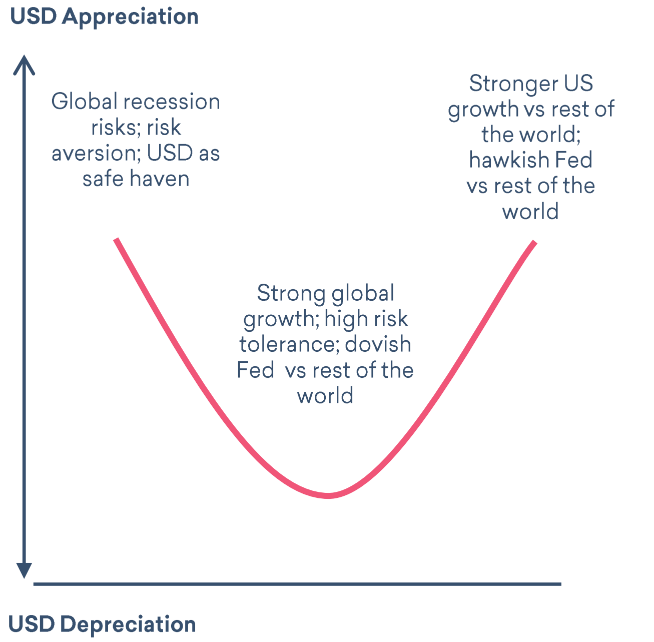


Source: World Bank, FRED, TBC Capital

In the current environment – the risk-off corner of the "dollar smile" (Figure 2) – safe-haven flows into the USD, albeit relatively less so than historically, have been supporting the greenback. Higher gold prices, however, help offset the resulting pressure on the exchange rate, effectively acting as an automatic stabilizer. In fact, compared to February 27, the UZS has weakened by a noticeably smaller margin than the currencies of its main trading partners – the EUR, CNY and RUB (Figures 3 and 4). This resilience becomes particularly clear when comparing Uzbekistan's terms of trade (ToT) dynamics to other countries. During global upswings, the country tends to benefit – albeit, naturally, to a lesser degree – from improving terms of trade alongside commodity exporters.

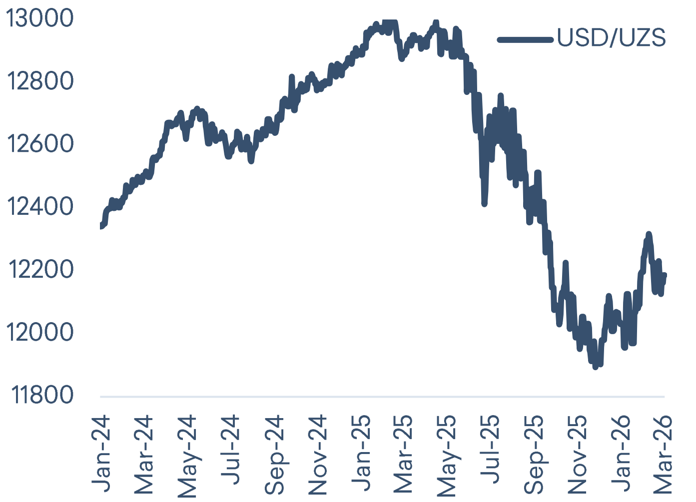
At the same time, it avoids the sharp downturns typically associated with commodity busts (Figure 5). The reason is straightforward: Uzbekistan's key export commodities are inversely correlated with one another, offsetting the effects of economic cycles.

FIGURE 2: USD STRENGTH CAN BE DRIVEN BY STRONG US GROWTH OR GLOBAL RISKS



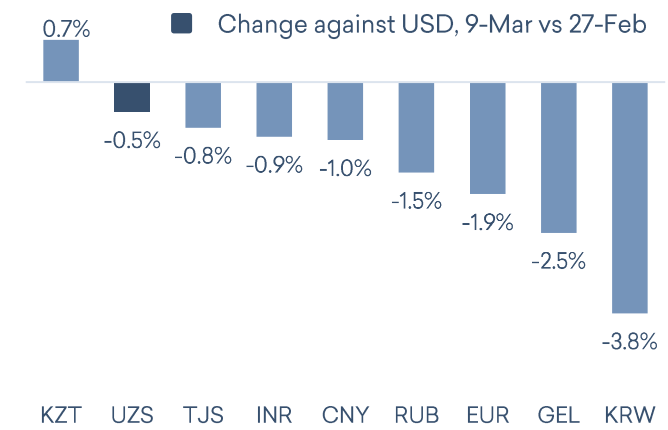
Source: TBC Capital

FIGURE 3: THE UZS HAS APPRECIATED STRONGLY SINCE EARLY 2025



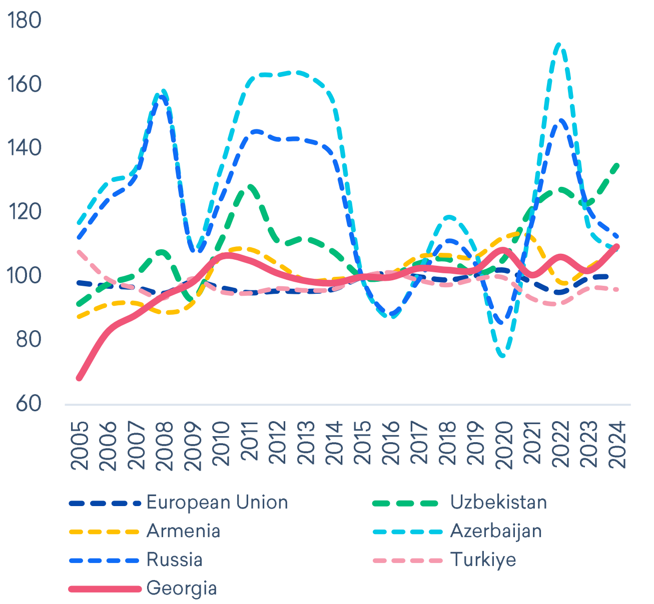
Source: CBU

FIGURE 4: THE UZS HAS LOST LITTLE GROUND AGAINST THE USD, UNLIKE OTHER CURRENCIES



Source: Bloomberg

FIGURE 5: UZBEKISTAN'S TERMS OF TRADE RISE DURING UPTURNS, BUT ALSO REMAIN RESILIENT DURING STRESS (Index in USD, 2015 = 100)

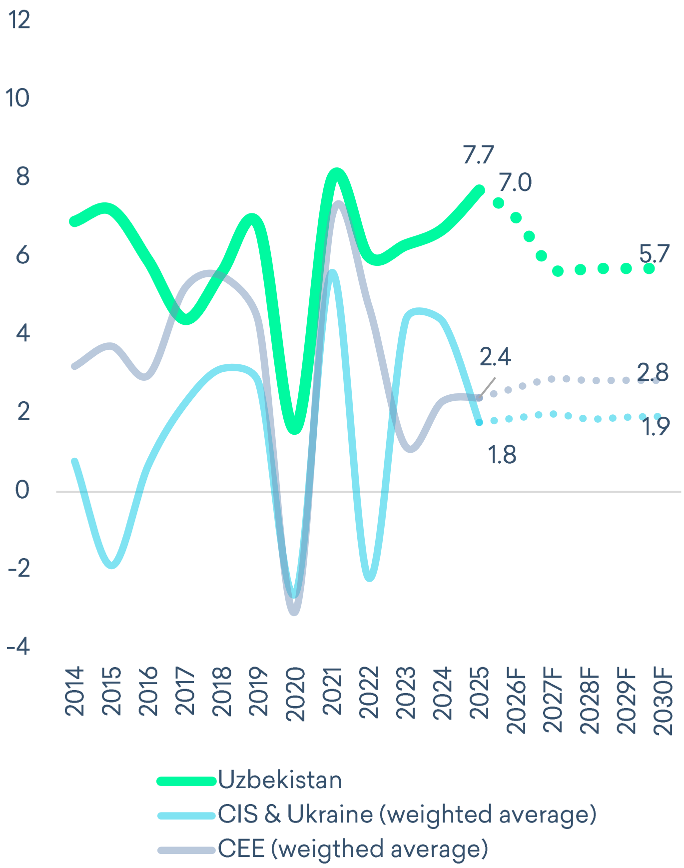


Source: UN

As for other direct channels of impact, the tourism industry, where the effects of conflict escalation tend to be felt almost immediately, represents a rather small fraction of Uzbekistan's foreign currency inflows. Tourism revenues accounted for just over 13% of exports of goods and services in 2025. Furthermore, according to the World Tourism Organization, visitors from Europe made up c. 95% of overall tourist arrivals in 2024, while the Middle East contributed only 0.2%. There is limited direct exposure in terms of goods exports as well, with Russia, China and the EU remaining Uzbekistan's three largest export markets. Exports to Afghanistan (4.5%) and the UAE (2.1%) could potentially be more affected, though their share is small, and these two countries also rank among the main destinations for oil exports, the prices of which have surged in recent days.

More broadly, the external balance sheet has been steadily improving. Non-gold exports have continued to expand alongside non-monetary gold exports, portfolio and direct investment inflows have accelerated, and FX reserves have returned to accumulation even after adjusting for higher gold prices. Facing the current shock from a position of strength naturally reduces the potential passthrough to the domestic economy.

FIGURE 6: ECONOMIC GROWTH IN UZBEKISTAN IS EXPETED TO REMAIN HIGHER THAN PEERS



Source: IMF, TBC Capital

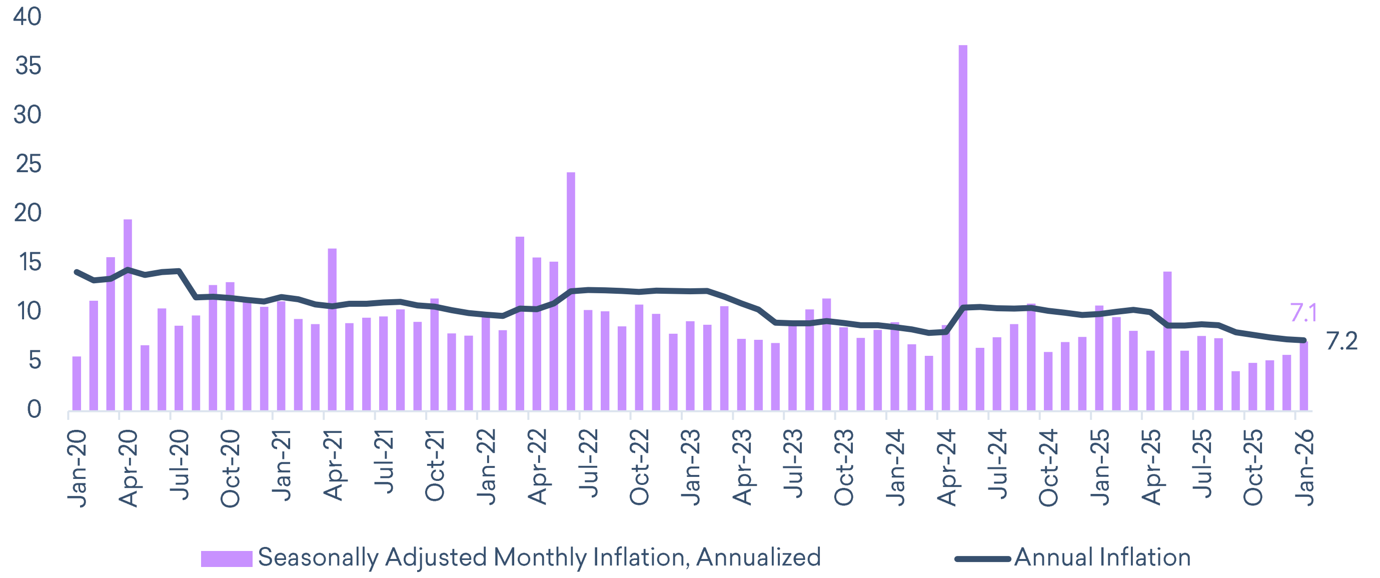
Overall, based on this judgement, the impact on economic growth – averaging 7.7% in 2025 and projected to total 7% in 2026 (Figure 6) – is expected to be limited, unless, of course, the security situation in the region deteriorates materially further. As for oil prices, the supply appears under little threat, given over 80% of oil is imported from Russia. Higher prices, however, are still likely to add to inflationary pressures, as is the case elsewhere. Roughly a quarter of global fertilizer shipments also pass through the Strait of Hormuz, meaning a sustained disruption could put upward pressure on global food prices. That said, any potential impact from this channel – much like oil, as well as transportation costs in general – is certainly not unique to Uzbekistan, and, as of today, is still expected to be temporary. In light of higher uncertainty, the CBU might consider delaying policy rate cuts, though, as we show below, this does not necessarily translate into prevailing market interest rates.

Now, what about more medium-term, structural drivers? Our readers will recall that, as we argued in our November paper [examining the forces behind surging gold prices](), the recent UZS strength reflects more than just gold and USD tailwinds. The greenback has since regained some ground, though, as discussed above, demand for gold remains elevated.

A more important driver – we'd argue, perhaps, the most important one – is inflation. We demonstrated that there had been a vicious cycle between inflation and UZS depreciation – while currency weakening fed into inflation through higher import prices, elevated inflation in turn required nominal depreciation to offset real appreciation. Achieving the inflation target therefore, by necessity, implies exchange rate stability, a central point we have consistently emphasized.

Inflation has continued to decelerate over the past year, now down to 7.2% as of January 2026. Since base effects continue to play a significant role, what's even more important for assessing underlying trends is monthly annualized inflation – that is, the annual inflation rate implied if the current monthly pace were to persist for the next 12 months. Adjusting for seasonal factors, monthly annualized inflation has averaged 5.4% over the past five months, even falling below the 5% target in September, before edging back up to 7.1% in January (Figure 7).

FIGURE 7: MONTHLY DYNAMICS HAVE INDICATED SIGNIFICANT DECELERATION IN INFLATIONARY PRESSURES SINCE SEPTEMBER 2025, WITH ANNUAL INFLATION ALSO DECLINING



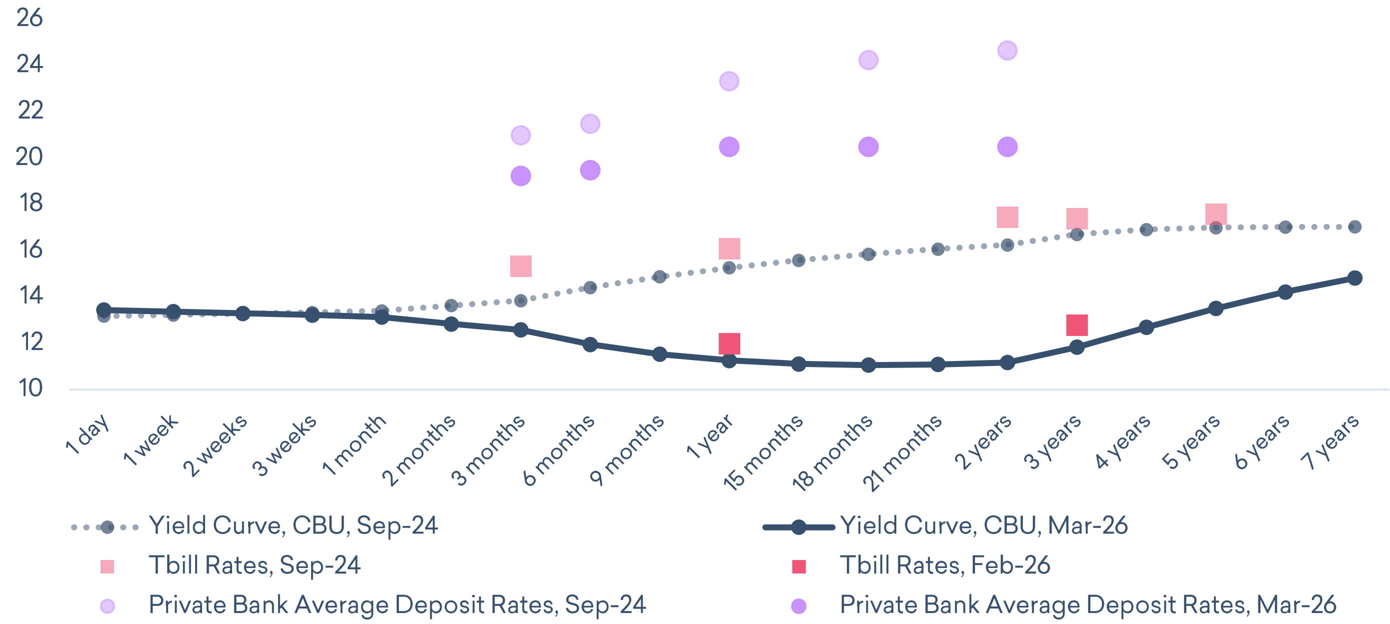
Source: Uzstat, TBC Capital

It is not just contemporaneous import prices, however, through which the exchange rate affects inflation. Crucially, it is also expectations of future inflation. As depreciation expectations decline, so do inflation expectations. How do market participants adjust to this new equilibrium? Straightforward – they demand a smaller risk/inflation premium. A smaller premium means lower interest rates, especially at the long end. Ergo, our long-standing argument for "locking in the UZS long end".

This all sounds nice and clear in theory, but do the data back it up? Absolutely. Let's take a closer look at how the UZS yield curve has evolved since our original publication (Figure 8). The curve has shifted from a steep upward slope to a humped, partially inverted shape – just as we argued it should have been. We also observe a strong decline in medium- and long-term yields, whereas the shorter end is broadly unchanged. This is a classic case of bull flattening, which, as the name suggests, is typically interpreted as a bullish signal for the economy. There are a few points we'd like to particularly highlight:

- The inverted 1M-2Y segment of the yield curve signals that the market expects interest rates to decline over the next couple of years. As we noted previously, even with an unchanged policy rate, market rates – including the interbank (UZONIA) rate – had already begun to decline.
- Falling long-end yields suggest lower long-run inflation expectations and/or a reduced term premium, reflecting disinflation and UZS stability. At the same time, the long end remains upward-sloping, implying that the market still anticipates robust economic growth and no deflationary pressures.
- Government T-bill yields and private bank deposit rates have moved in step. Deposit rates at the long end have dropped by almost 500 basis points, consistent with our forecasts.

FIGURE 8: INTEREST RATES HAVE DECLINED AND THE YIELD CURVE HAS INVERTED, IN LINE WITH OUR FORECASTS, THOUGH DEPOSIT RATES STILL REMAIN TOO HIGH



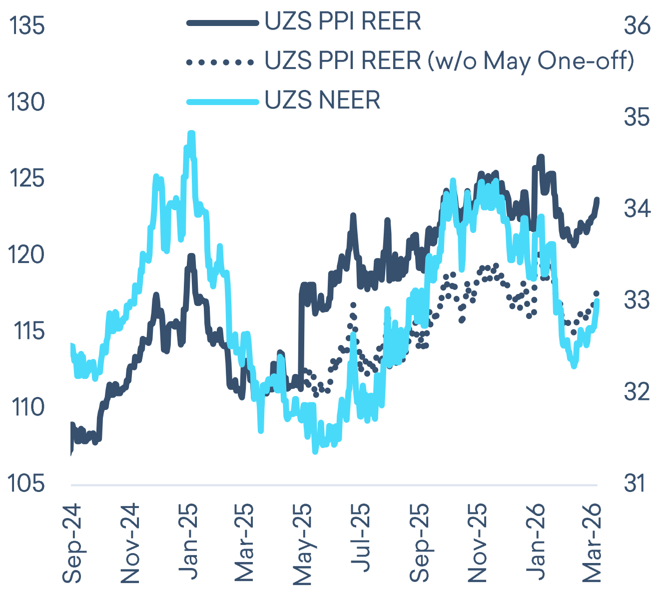
Source: Uzstat, TBC Capital

The case of locking in the long end rested on two main arguments: the large gap between private deposit and government security rates, and a lower rate outlook. While not the market consensus at the time, the yield curve has now inverted, and the gap has narrowed, indicating that commercial banks are now focusing more on short term liabilities and longer term fixed assets, taking into account the impact of the rate cycle on the net interest margin. This confirms our original thesis – market expectations are consistent with lower rates, declining inflation risks, and sustained UZS stability. Yet, the gap persists, and the long end is still relatively steep. Therefore, we continue to bet on lower rates – though, the adjustment is already well underway – and at least lower UZS depreciation going forward.

We keep getting asked how much exactly is "at least lower UZS depreciation". There are many ways to answer this question, as exchange rates are notoriously hard to predict, particularly in the near term. We prefer to focus on relatively more medium-term indicators, which form the backbone of our optimal foreign currency funding strategy, designed to leverage on underlying trends rather than short-run volatility. One such indicator, which could serve as a handy starting point, is the equilibrium real exchange rate (REER). Excess REER strength has historically resulted in UZS depreciation (Figure 9). We showed previously that, should inflation in both Uzbekistan and its trading partners converge to target levels over the medium-to-long run, the real exchange rate equilibrium would imply no change in the nominal exchange rate. Following up on this, as Uzbekistan's inflation is currently still c. 2 percentage points higher than the target, the implied annual UZS depreciation consistent with macro fundamentals is c. 2%. We expect the change in UZS to remain close to this number, with a range of perhaps +/- another 2%, over the next year or so.

At the same time, we should note that much depends on what happens with respect to Uzbekistan's major trading partner currencies – the CNY, RUB and EUR. A material downside for any of them would naturally generate spillover risks for the UZS, even if part of this shock would be mitigated by the economy's structural resilience. In this regard, a potential adverse scenario could be a stronger USD in parallel with a commodity crunch, cutting into the value of Uzbekistan's procyclical commodity exports and gold prices simultaneously, akin to the 2014-2016 developments. During this period, Uzbekistan's total exports and the economy were largely unaffected only due to the resurging gold mining sector – hence, increased production rather than economic diversification – which is less likely to be the case going forward. That said, the probability of this scenario remains rather low, as the relative USD weakness over the past year reflects a range of structural drivers, including the debasement trade, gradual erosion of the USD safe haven status, and structural de-dollarization of central bank reserve assets.

FIGURE 9: THE REER HAS STRENGTHENED BUT NOT AT OVERLY HIGH LEVELS



Source: Statistics Offices, TBC Capital

Now that the stage has been set, we can go back to the question posed in the title. Could the UZS really be called a safe haven asset? Not entirely of course, no emerging market currency can, but the UZS risk-adjusted return is certainly very impressive. The structural resilience of the economy allows it to significantly limit – and, in part, benefit from – periods of stress, while also growing fast – fastest in the region – during upswings (Figure 6). What's just as important, though, is that the market has still not fully priced this in, just like two years ago, when we argued against the then consensus view. Since then, substantial progress has been made, and market expectations have come a long way, though, in our view, still remain somewhat behind. Two years from now, this question might sound quite a bit more straightforward.

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