TBC CAPITAL

MACRO UPDATE – UZBEKISTAN

The UZS: Yes, It's All About Inflation Targeting

1 May 2026

"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. Believe me, it will be enough"
– Mario Draghi, former ECB president

TBC Group Chief Economist Office

KEY TAKEAWAYS

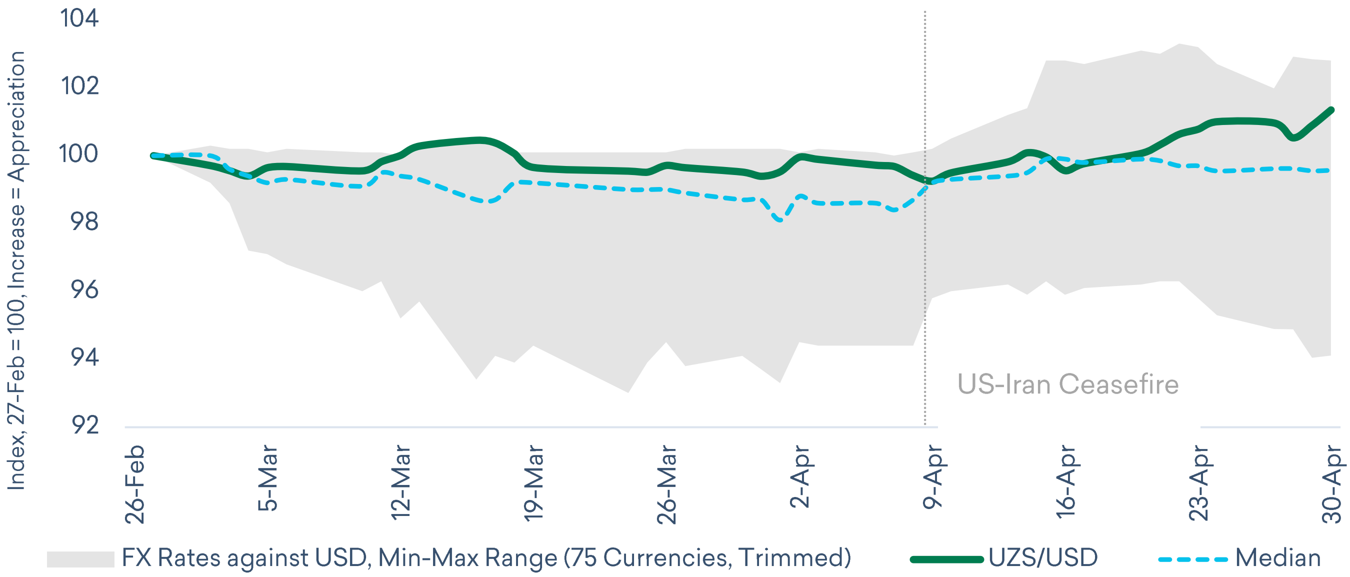
- Despite gold prices easing from record-high levels and a stronger USD following the Middle East escalation, the UZS has demonstrated remarkable stability, outperforming peers;
- While external factors play a role, it is, ultimately, about inflation targeting and its credible implementation – the single most important driver for the UZS outlook, as we have argued over the past two years;
- Inflation has continued to moderate, falling below target for the first time in seasonally adjusted monthly terms in Sep-25, while expectations have become more firmly anchored;
- However, in April, the UZS yield curve – having appropriately inverted in 2026 – has steepened at the long end, which, in our view, runs counter to the broader trend and outlook, suggesting scope for further compression in yields;
- We argue that the curve should be more inverted at the front, lower at the belly, and significantly lower at the long end, as we expect the market to continue to tilt bullish – as it has over the past two years – pricing in structural changes in the macro regime;
- In practical terms, locking in the UZS long end remains attractive, as we continue to bet on lower inflation, lower rates and at least lower UZS depreciation going forward;
- Same holds for hedging costs, which are now much lower, though still expensive, in our view;
- Lower yields on the back of disinflation and an also lower depreciation risk premium, in turn, support higher corporate valuations.

It has been 50 days since we posed a bold, if slightly provocative, question – how exaggerated would it be to call the UZS a safe haven? The Middle East conflict had begun just over a week earlier, market sentiment had soured, volatility had spiked, and the USD had strengthened on the back of risk-off flows coupled with surging yields. Unlike the broader currency universe, however, the UZS had lost little ground, in line with our forecasts.

Part of this resilience could be attributed to the initial rise in gold prices, underscoring the structural characteristics of the Uzbek economy, which has historically benefited from the inverse relationship between its key export drivers – countercyclical gold on the one hand and procyclical commodities on the other. The only problem, of course, is that the gold rally proved short-lived, as inflation fears weighed on the bullion. Yet, even amid the rather unpleasant combination of falling gold prices and USD appreciation – ostensibly a stress scenario for Uzbekistan – the UZS has demonstrated remarkable stability.

In fact, measured against the CBU's cohort of partner currencies*, the UZS has remained a top performer throughout March and April. Not only did it barely budge when the vast majority of peers weakened against the USD ahead of the ceasefire – with dispersion widening markedly on the downside – but it also strengthened thereafter, reaching the 91th percentile as of 30 April (Figure 1).

FIGURE 1: THE UZS HAS CONSISTENTLY BEEN A TOP PERFORMER WHEN COMPARED TO PEER CURRENCIES SINCE THE MIDDLE EAST ESCALATION (Index, 27-Feb = 100, Increase = Appreciation)



*Top and bottom three currencies removed each day to exclude outliers.

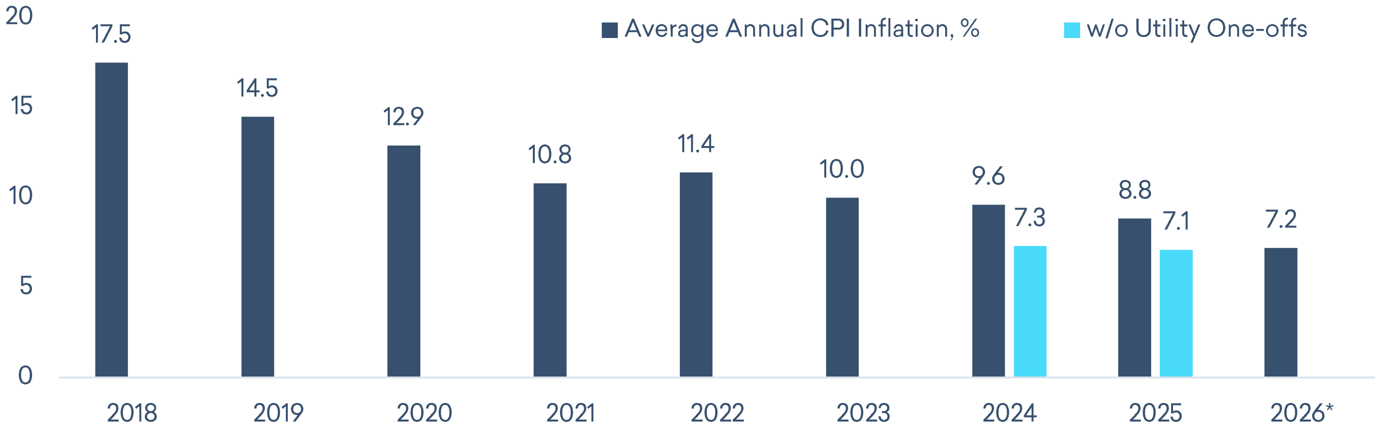
Source: CBU, TBC Capital

Why, then, has the UZS not depreciated despite the unfavorable external backdrop? The answer lies in neither USD nor gold dynamics, though they certainly play a role. It is, ultimately, about inflation targeting – the single most important driver for the UZS outlook, as we have argued over the past two years. The credibility of the monetary framework, reflected in a clear and sustained disinflationary trend, has gone a long way in anchoring expectations, thereby supporting exchange rate stability and strengthening the case for a structural – rather than temporary – shift in the macroeconomic regime.

Put simply, the CBU takes its mandate seriously, with the capacity to fully implement the inflation targeting framework improving considerably over the past few years, as confirmed by the IMF – projecting inflation to decline to the 5% target next year despite the Middle East war spillovers. As our readers are well aware, the importance of disinflation for exchange rate stability – and vice versa – cannot be overstated. This thesis has formed the backbone of our bullish stance on the UZS over the past couple of years, with our 2024 flagship paper laying out the rationale, then against the market consensus. We demonstrated that there had been a vicious cycle between inflation and UZS depreciation, causing self-reinforcing feedback loops. Curbing one, therefore, necessarily implies curbing the other.

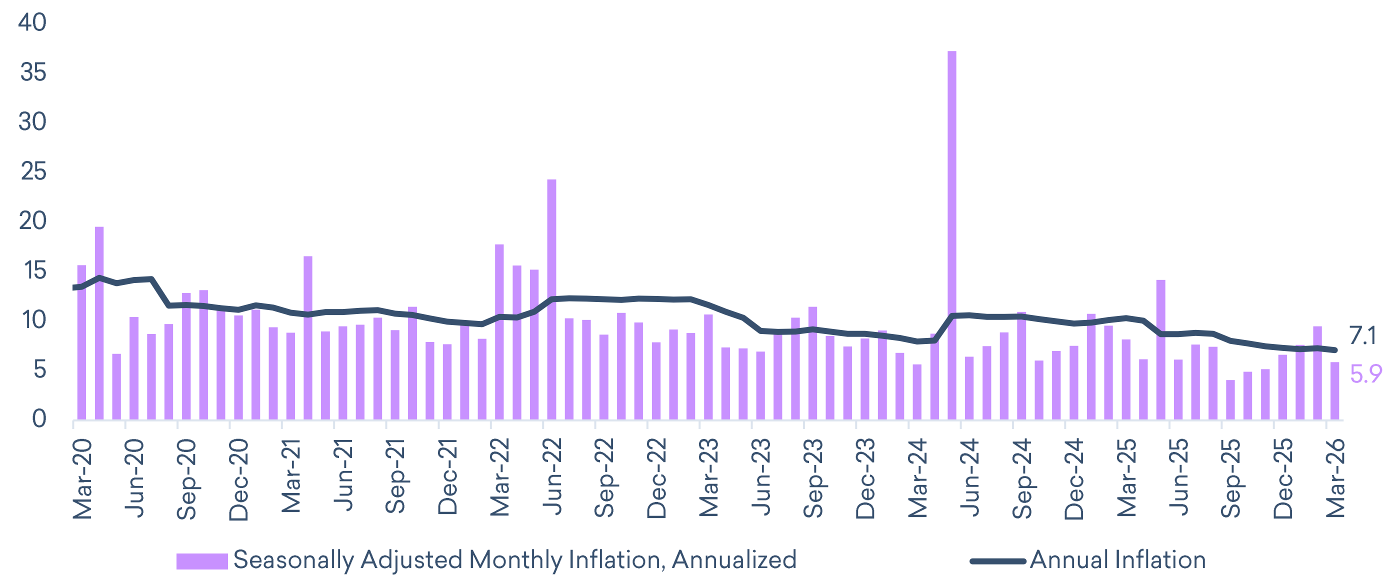
With this in mind, annual inflation has continued to decline in 2026, averaging 7.2% in the first three months of the year, compared to 8.8% and 9.6% in 2025 and 2024 respectively (Figure 2). Underlying trends point to even stronger disinflation. Excluding one-off utility price adjustments, inflation would have been 2 percentage points lower on average in 2024-2025. At the same time, monthly annualized inflation – that is, the pace implied if current monthly trends were to persist – has averaged 6.3% since falling below the target for the first time ever in September 2025, standing at 5.9% as of March 2026 (Figure 3).

FIGURE 2: ANNUAL INFLATION HAS STEADILY DECLINED OVER THE PAST FEW YEARS (%)



Source: CBU, TBC Capital

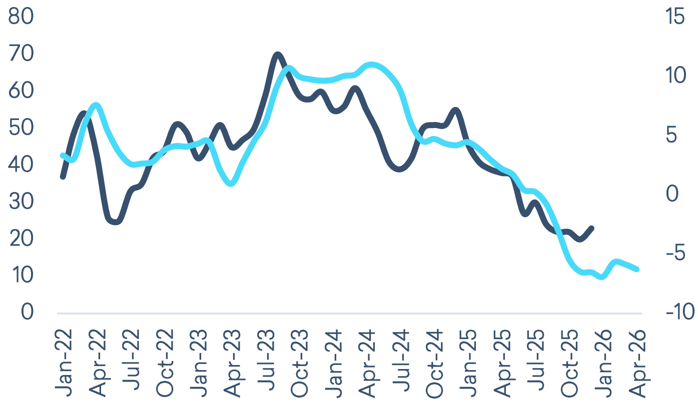
FIGURE 3: ANNUALIZED MONTHLY INFLATION FELL BELOW THE 5% TARGET FOR THE FIRST TIME EVER IN SEPTEMBER 2025, AND NOT STANDS AT 5.9% AS OF MARCH 2026



Source: CBU, TBC Capital

There are two main channels through which exchange rate stability affects inflation. A stronger currency contains the passthrough from import prices. This is the contemporaneous impact. On top of this, there is inflation expectations – the cornerstone of the inflation targeting regime. As depreciation expectations decline, so do inflation expectations, anchoring them around the central bank's target. This dynamic has played out in real time in Uzbekistan. The share of respondents citing exchange rate fluctuations as a key driver of their inflation expectations declined to 23% as of December 2025, in parallel with UZS appreciation (Figure 4). For comparison, this number stood at 51% in October 2024, when we first published the flagship note.

FIGURE 4: AS DEPRECIATION EXPECTATIONS DECLINE, SO DO INFLATION EXPECTATIONS

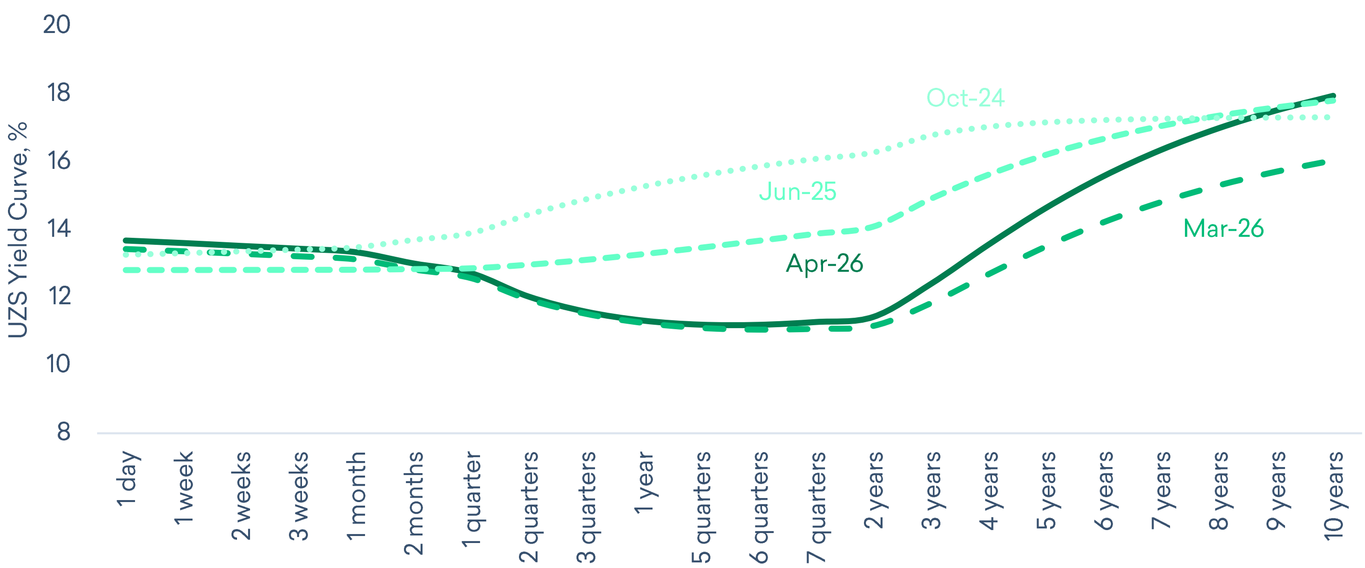


Source: CBU, TBC Capital

Lower inflation and depreciation expectations, in turn, imply lower interest rates, the other element of the trio – both in the near term, through expected monetary easing, and over the longer horizon, via a reduced risk premium. This has underpinned our long-standing rationale to lock in the UZS long end. In the March update, we highlighted that the yield curve had shifted from a steep upward slope to a humped, partially inverted shape, in line with our expectations. Consequently, it came as little surprise when Uzbekistan issued 3-year local currency sovereign bonds at a historic low rate of 12.25% in April, a striking negative term premium relative to the 14% policy rate, and a validation of our long-held view that the yield curve should be inverted.

Figure 5 plots the UZS yield curves at four different points in time, corresponding to the dates of our publications, including this one. The October 2024 upward-sloping curve flattened in June 2025 before appropriately inverting in March 2026, a typical case of bull flattening. In April, however, yields at the longer end – from 2 years – have increased again, with the 10-year yield now even higher than it was in 2024. There are several points we'd like to emphasize here.

FIGURE 5: THE UZS YIELD CURVE HAS SHIFTED UP AGAIN IN APRIL FOR LONGER MATURITIES (%)

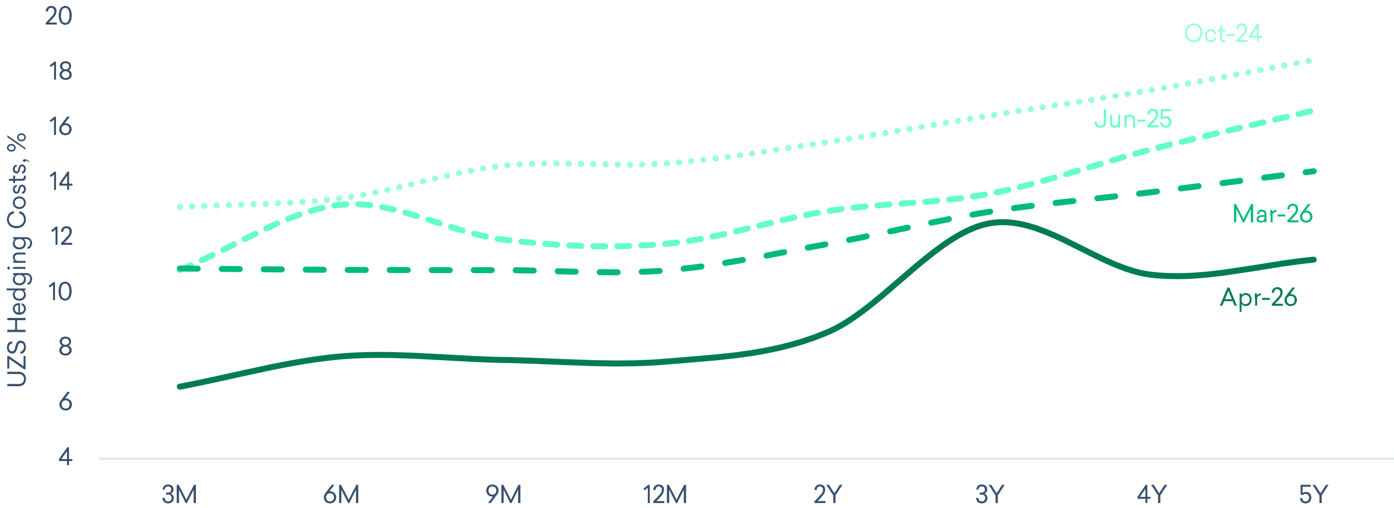


Source: CBU, TBC Capital

First, we'd argue the current curve still steepens too soon – in other words, it should remain inverted over a longer time horizon. Setting aside the term premium for a moment, the 2-year trough at 11.25% implies a nominal neutral rate of the same magnitude, which appears too high if one takes the 5% inflation target seriously. A real neutral above 6% sits well above the bulk of EM estimates in the literature (typically around 3% on average and 4-5% at the upper end). A credible curve, in our view, would price the neutral nominal rate closer to 8-9%, which means the belly should be 200-300 basis points (bp) lower. As inflation is expected to reach the target in 2027, the policy rate is likely to converge to the neutral rate later, which is at odds with the observed steepening of the curve from 6 quarters onwards.

Now, of course, the term premium plays a significant role in emerging economies such as Uzbekistan, which are inherently riskier – a structural feature, not an anomaly. The question is one of magnitude. The term premium estimation is subject to considerable uncertainty and we don't have a magic number to provide, as we see a range of plausible outcomes. What we do fully agree on, though, is that it is highly unlikely to fully explain the 200-300 bps gap, especially within a month's time, absent a material shift in fundamentals. We also note that, over the same one-month period, UZS hedging costs shrank by 300 bps on average, including by 320 bps for 5-year maturities, though, in our view, this is still too expensive. While bond and FX markets are not directly comparable, this reinforces the case for lower yields at least up to the belly, since hedging costs reflect implied UZS rates priced via covered interest parity (Figure 6). Should the curve be upward-sloping at longer maturities? Absolutely – we argue for a cyclical inversion, not a structural one, and credible policy coupled with robust growth implies higher yields at the long end – though the belly doesn't look to be going low enough at the moment, unlike the front end.

FIGURE 6: UZS HEDGING COSTS HAVE DECLINED ACROSS THE CURVE OVER THE PAST YEARS



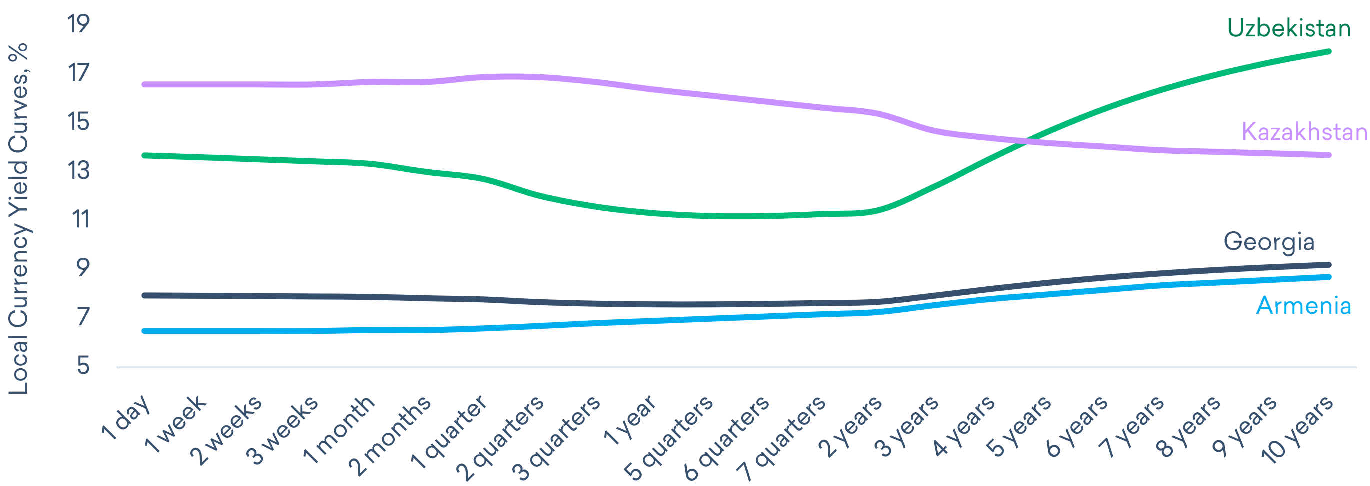
Note: UZS Hedging costs correspond to ask yields.
Source: Bloomberg, TBC Capital

Second, not only does the curve steepen early, but the long end is also too high. The current spread between 10-year and 2-year yields is over 600 bps, a huge gap by any measurement. While Uzbekistan doesn't have a long track record of inflation targeting, which does warrant a higher risk premium, the widening of the spread from 100 to 600 bps over the course of the past two years cannot be explained by structural issues that had been there from the very beginning – and, if anything, have only improved since.

Furthermore, it's not just that the spread is too high right now, it's also the fact that it has constantly been growing, as the 2-year yield has fallen while the 10-year has barely moved (Figure 5). In fact, Uzbekistan's current 10-year yield dwarfs those of peer countries, even as Kazakhstan's policy rate stands at 18% as opposed to Uzbekistan's 14% (Figure 7). A valid counterpoint is that Uzbekistan has only just adopted the inflation targeting regime and has some way to go before yields shrink on the back of policy credibility, as well as the fact that these economies stand at different points in easing/tightening cycles and have varying market depth. This is certainly true, though the structural resilience of the Uzbek economy, as described above, also represents an upside in terms of compressing yields by virtue of limiting large price swings in both directions.

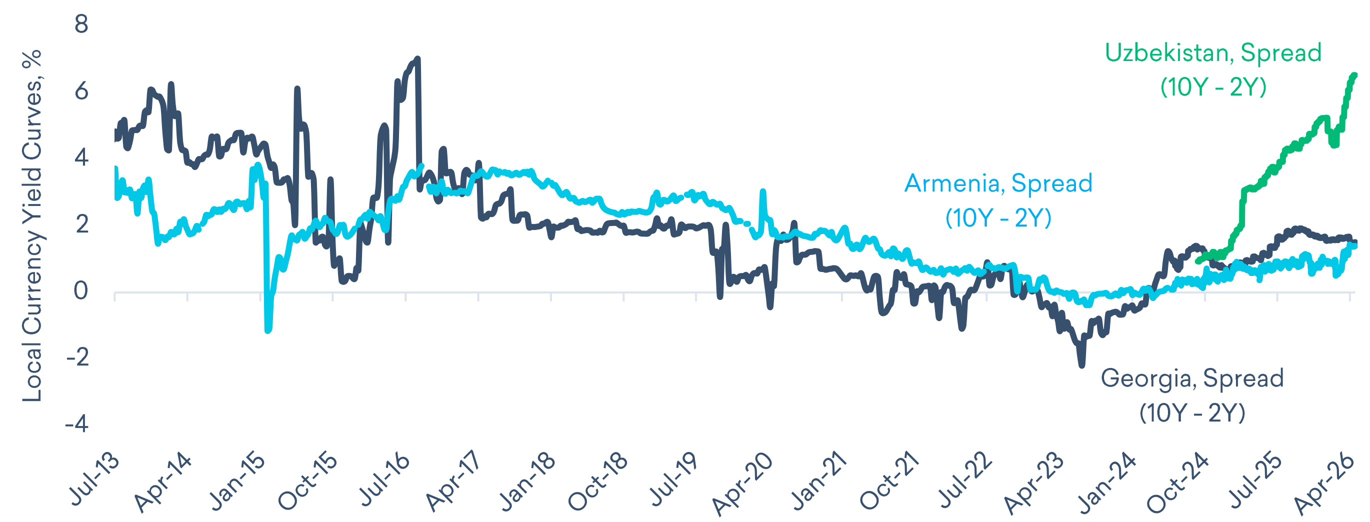
Nevertheless, what is striking is that the current Uzbekistan spread is significantly higher than the comparable spread observed in peers that had, by then, recently adopted inflation targeting. Contrasting the 10-year and 2-year spread to historical spreads for Georgia and Armenia, one can easily see that the term premium had consistently been much lower than 600 bps – and on a downward trend – when these countries were also new to inflation targeting (Figure 8).

FIGURE 7: UZS YIELDS AT THE LONG END DWARF THOSE OF PEER COUNTRIES AS OF APRIL 2026



Source: National Banks, TBC Capital

FIGURE 8: THE SPREAD BETWEEN UZS 10-YEAR AND 2-YEAR YIELDS IS TOO HIGH AND ON AN UPWARDS TREND, CONTRADICTING HISTORICAL PERFORMANCE IN PEER COUNTRIES



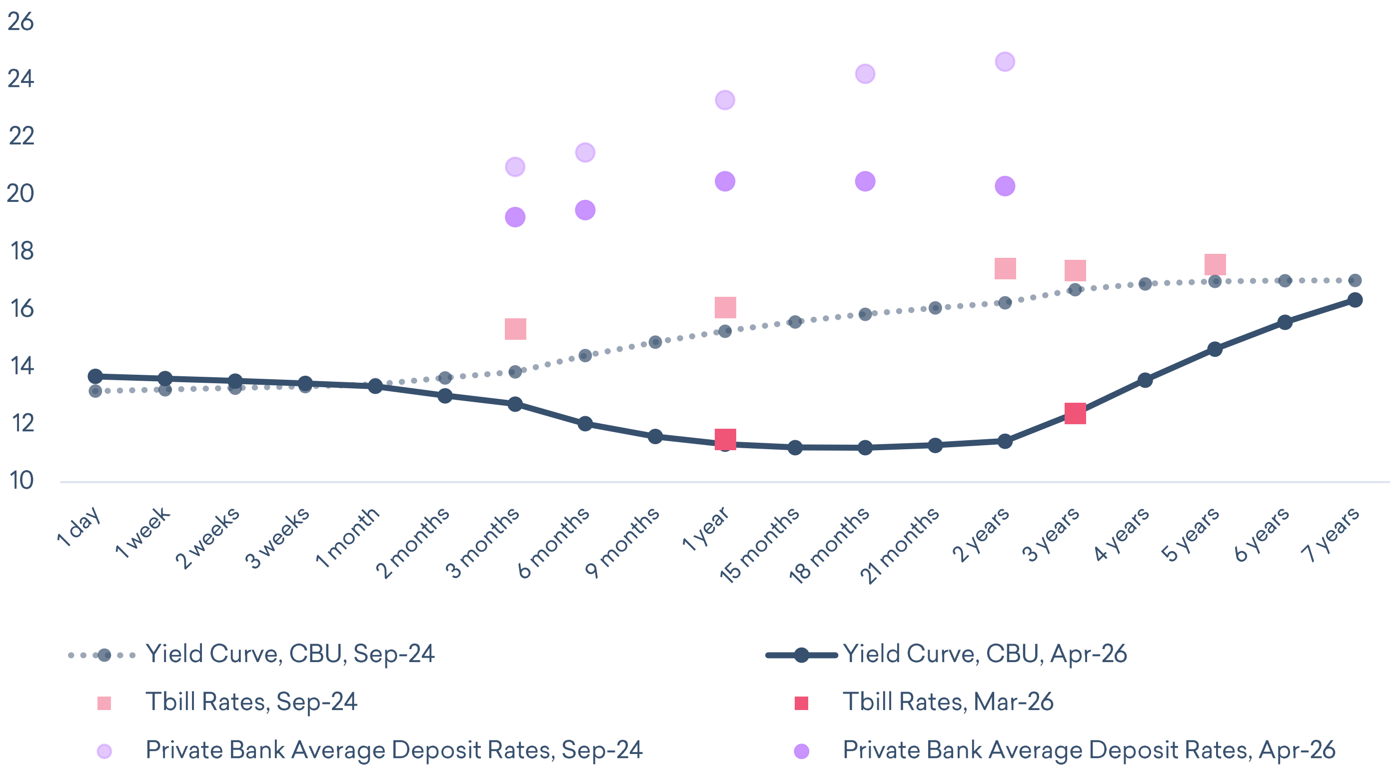
Source: National Banks, TBC Capital

Consequently, April dynamics, in our view, appear inconsistent with the broader trend, assuming they reflect genuine market sentiment. In fact, a reasonable case can be made that March yields were themselves already elevated, even if our outlook leans more bullish than market consensus – again, not to provide a magic number. That said, the past two years have seen meaningful realignment, with sentiment becoming increasingly confident. At the same time, a crucial caveat is that Uzbekistan has not issued 10-year government bonds in years, and last issued a 5-year bond in August 2025, with most of the trading concentrated over 1-to-3-year maturities. This means that while longer end yields exist on the curve, they might not accurately represent prevailing market rates but rather indicative/extrapolated ones, warranting caution in interpreting recent moves.

Beyond the sovereign curve, private bank deposit rates – which we have been highlighting as the key source of value – have moved in lockstep with declining yields since 2024, but still have a long way to go (Figure 9). Deposit rates at the long end have dropped by 450 bps, flattening the deposit curve, though the spread compared to the yield curve remains around 900 bps, well above arbitrage conditions.

Bottom line – we argue that the curve should be more inverted at the front, lower at the belly, and significantly lower at the back. While one can argue just how high or low exactly the yields should be, it is abundantly clear that the current long-term yields are way too high. So long as yields on longer maturities remain elevated, and the gap between deposit and market rates persist, locking in the long end remains attractive, as we continue to bet on lower inflation, lower rates and at least lower UZS depreciation going forward.

FIGURE 9: PRIVATE BANK DEPOSIT RATES HAVE FALLEN SIGNIFICANTLY OVER THE PAST TWO YEARS, IN LINE WITH PROJECTIONS, THOUGH THE GAP TO THE YIELD CURVE REMAINS SIZEABLE, AND, WHILE IT HAS FLATTENED, THE DEPOSIT CURVE SHOULD ALSO BE INVERTED (%)

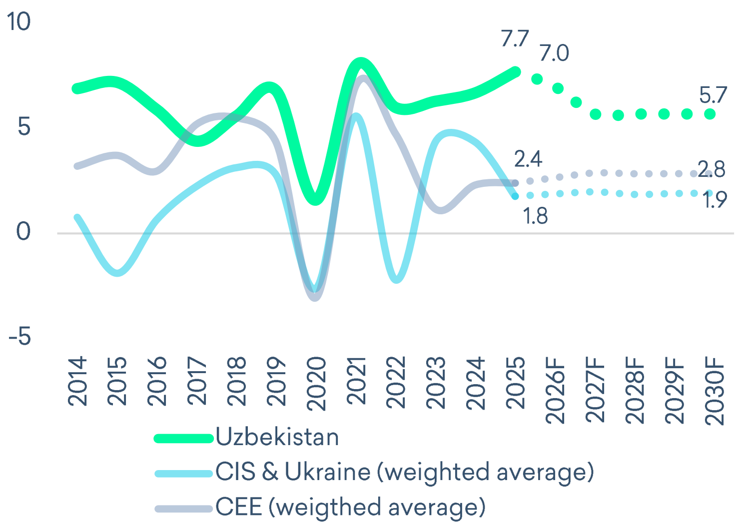


Source: CBU, Ministry of Finance, TBC Capital

Risks to the outlook remain, however, particularly against the current backdrop of geopolitical tensions. As we always highlight, 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, compressing both procyclical exports and gold revenues simultaneously, akin to the 2014-2016 developments. During this period (Figure 10), 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.

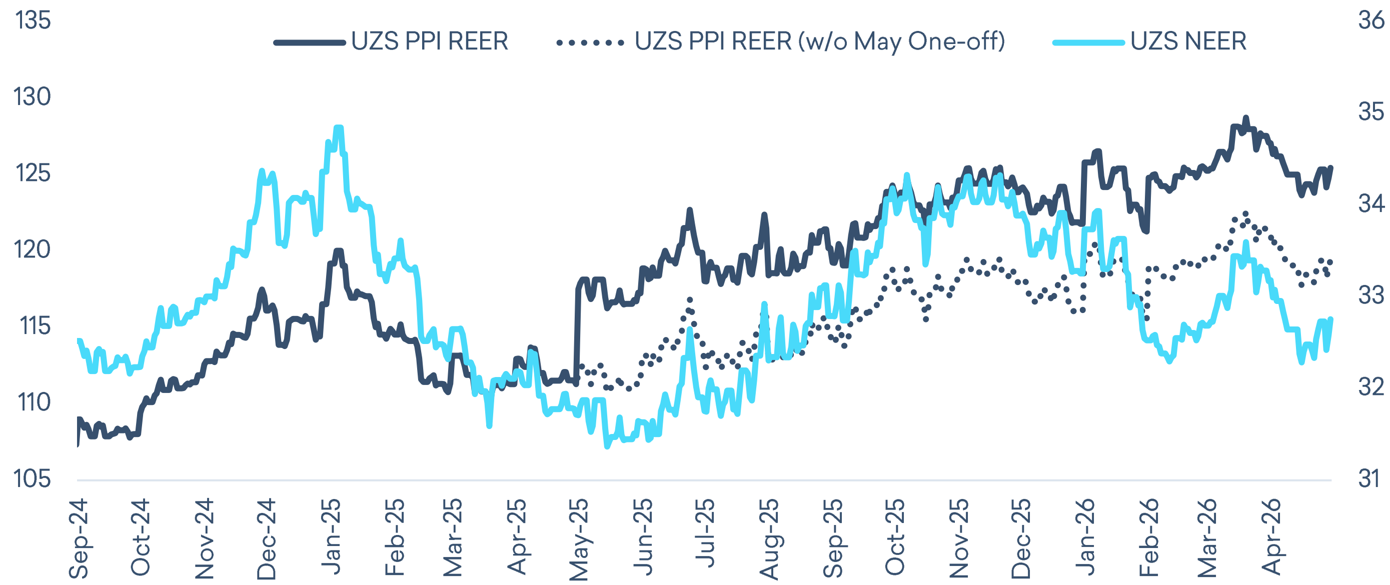
FIGURE 10: ECONOMIC GROWTH IN UZBEKISTAN HAS BEEN RESILIENT AGAINST EXTERNAL SHOCKS



Source: IMF, TBC Capital

That said, the UZS has proved resilient in the face of a strong greenback and weak bullion over the past two months, a mini version of exactly the stress scenario described above. This conforms to our assertion that lower gold prices don't necessarily imply UZS weakness, and, likewise, vice versa. Furthermore, the relative USD strength has proved temporary, in line with expectations, as, in our view, structural gold-positive and USD-negative drivers remain largely intact. As for excess real exchange rate (REER) strength, which has historically resulted in UZS depreciation, we see little evidence in this regard, with the REER even edging downwards in April driven by RUB and KZT appreciation (Figure 11), keeping in mind the slight undervaluation in PPP terms.

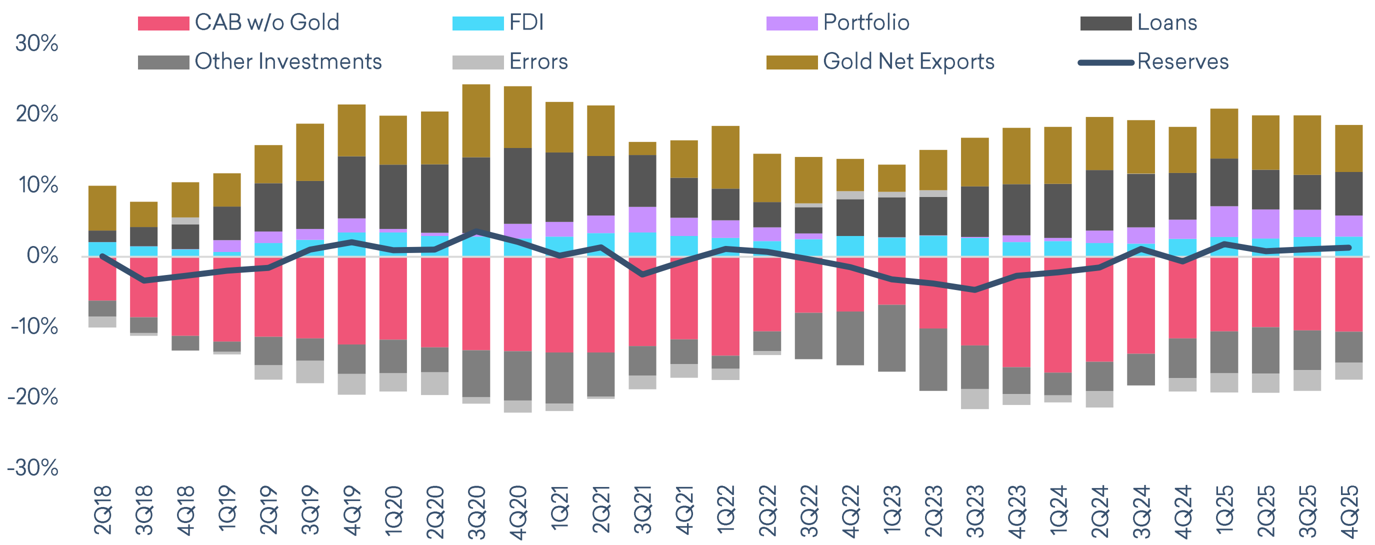
FIGURE 11: THE REAL EXCHANGE RATE HAS APPRECIATED, THOUGH NOT TO OVERLY STRONG LEVELS, MODERATING IN APRIL DUE TO RUB AND KZT STRENGTHENING (Index, Jan-13 = 100)



Source: CBU, TBC Capital

The external position has also improved. The non-gold current account deficit has continued to narrow, while gold exports, together with loans, remain the primary sources of financing, supported by rising non-gold exports (Figures 12 and 13). Portfolio investment inflows have accelerated as well, in parallel with a rising number of bond issuances from both the government and the private sector, reaching 3% of GDP by the end of 2025.

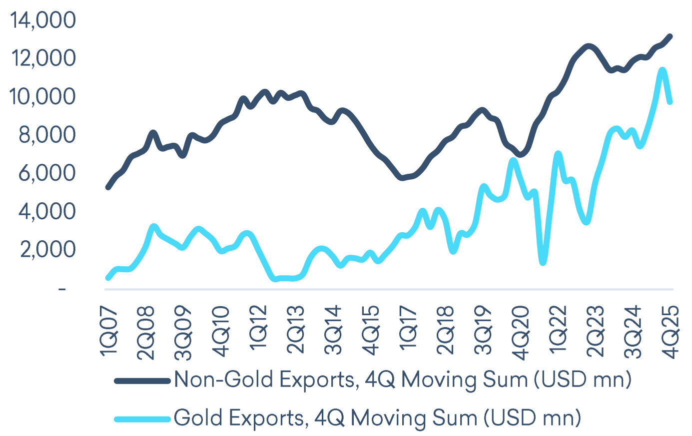
FIGURE 12: THE NON-GOLD CURRENT ACCOUNT DEFICIT HAS NARROWED IN 2025, WHILE INVESTMENT INFLOWS HAVE ACCELERATED (% of GDP, 4Q Moving Sum)



Source: CBU, TBC Capital

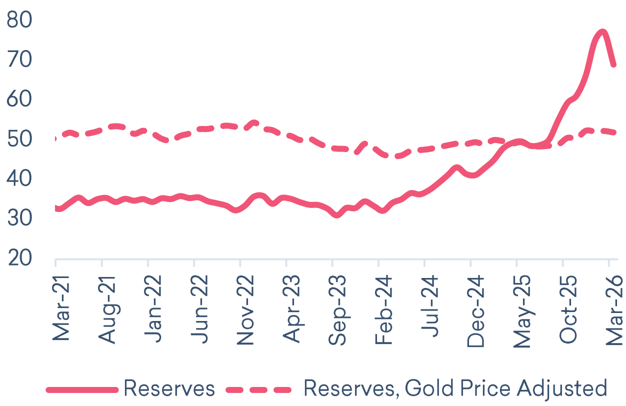
Balancing financing sources and needs, gross reserve assets (excluding gold price effects) grew by USD 2 bn (1.3% of GDP) in 2025, with reserves no longer used to finance the current account deficit for the first time since 2020. As of March 2026, reserves stood at 46.7% of GDP, up by 44% y/y, while gold price-adjusted reserves grew by 4.5% compared to March 2025 (Figure 14).

FIGURE 13: NON-GOLD EXPORTS HAVE BEEN RISING RAPIDLY



Source: CBU, TBC Capital

FIGURE 14: RESERVES GROWING EVEN ADJUSTING FOR GOLD PRICES (USD bn)



Source: CBU, TBC Capital

Summing up, the recent UZS strength is not merely a product of favorable external developments, nor a reflection of short-term dynamics. Rather, it is the result of structural change – chief among them the inflation targeting regime and its credible implementation. Has the market fully priced this in? Likely not, as was the case two years ago, though considerable progress has certainly been made. Our outlook remains unchanged: lower inflation, lower rates, and at least lower UZS depreciation going forward, estimated at around 2% with a range of ±2% over the next year or so, based on macro fundamentals as described also in this note.

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