IV quarter
2022

MONETARY POLICY REPORT

Tashkent
2023

In implementing monetary policy,
the emphasis will be placed on achieving **price stability in the economy** and **the medium-term inflation target of 5 percent**

Contents

INTRODUCTION

In recent quarters there has been a sustained high rate of **economic growth.** In the context of relatively moderate investment activity, the growth of aggregate consumption has been one of the main demand drivers. At the end of 2022 GDP growth corresponded the October forecast of the Central Bank, amounting **to 5.7 percent.**

Despite the expected relative stabilization of fiscal stimulus this year, lagged effects of the fiscal deficits, accumulated during the last 3 years, on aggregate demand persist. Stable labor market, rising wages and cross-border remittances boost the demand on durable goods and real estate, exerting price pressure in these markets.

The extent to which the current positive trends will stay in place depends on the stability of the supply factors, in the coming quarters. Meanwhile, some short-term supply-side risks have arisen because of abnormal weather conditions, which may affect the production and supply of certain goods.

Over 2022, the economy adjusted to changes in external conditions. The impact of external economic conditions was relatively short-lived and less pronounced compared to initial projections. This resulted in increased foreign exchange inflows from exports and cross-border remittances.

Alongside with expectations on more favorable prices on world markets, there are risks and uncertainties associated with lower global growth prospects and the prospects on key trading partners.

In 2022, there was a price increase over a wide range of goods, which has resulted in acceleration of annual headline inflation to 12.3 percent.

The core inflation also had a sustained growth path, having reached 13.8 percent, over the last six months of the year. This, together with relatively higher producer prices, is an indicator of rising inflationary pressures. Inflation expectations also show a moderate growth, in the last three months. Their direction raises the probability of upward shifts on inflation risks.

As the global economy adjusted to the ongoing changes and central banks tight their monetary policies, global inflationary trends and rise in on basic food prices gradually subside. Together with stable exchange rate, this may curb the inflationary processes in the economy.

Since the second half of the year, the growth of loans to the economy has slightly accelerated due to lending in domestic currency. Considerable growth is observed in retail lending.

Due to positive real interest rates, deposits, including those of households, increased rapidly.

Overall, since the second half of 2022, there were structural changes in the methods of financing the local economy. The transition of banks to internal sources of financing has accelerated. This, together with the effective accumulation of available financial resources, has contributed to the reduction of dollarisation in the economy. This expected to be continued in 2023.

According to preliminary estimates, the probability of real GDP growth slowdown in the first quarter of the current year is high, and by the end of 2023 the economy is projected to grow by 4.5-5 percent. According to baseline projections, the inflation is expected to be in 8.5-9.5 percent range, in 2023.

The room for the monetary policy may be limited, on the one hand, by accelerating core inflation and structural changes in the economy, and, on the other hand, by risks in an external environment and supply factors.

The Central Bank will continue to assess the impact of monetary conditions on demand, prices and inflation expectations carefully. The measures aim at balancing the supply and demand factors, rearing the inflation at the forecasted values, with the medium-term target of 5 percent.

Should the situation necessitate, Central Bank together with relevant ministries and departments, will take additional measures on reducing non-monetary inflationary factors, including the elimination of supply chain disruptions and ensuring the supply of required goods.

I. EXTERNAL CONDITIONS

1.1. Global economy

Having reached its decade high by the third quarter of 2022, global inflation began to slow down in the fourth quarter (Figure 1.1.1). However, inflation still remains above target in most countries. Meanwhile, the leading countries, which assessed inflation as temporary in the previous quarters, have also admitted that it is long-lasting and have started taking effective measures.

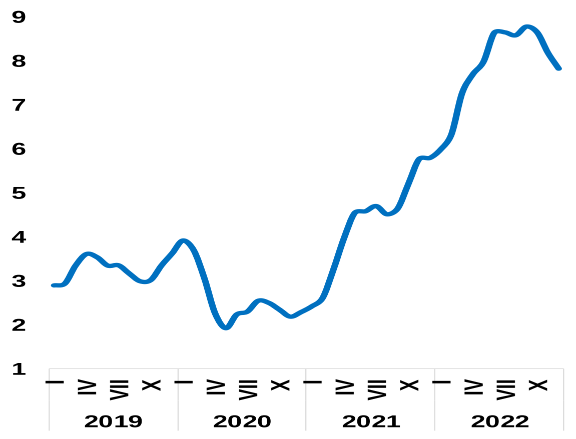
In particular, central banks actively continued the phase of monetary tightening, increased key rates, and cut quantitative easing programs implemented during the pandemic (Figure 1.1.2).

As a result, there is a decrease in headline inflation and food prices, and many central banks project inflation to continue declining steadily in 2023 and the targets to be reached in 2024.

The increase of key rates to curb inflation by developed countries is having a significant impact on financial markets, making borrowing and debt servicing more expensive for developing countries. Moreover, increased yields on government securities of developed countries is causing capital outflows from developing countries by influencing the decisions of investors. This can increase the risk of a debt crisis in some countries through a negative impact on fiscal indicators.

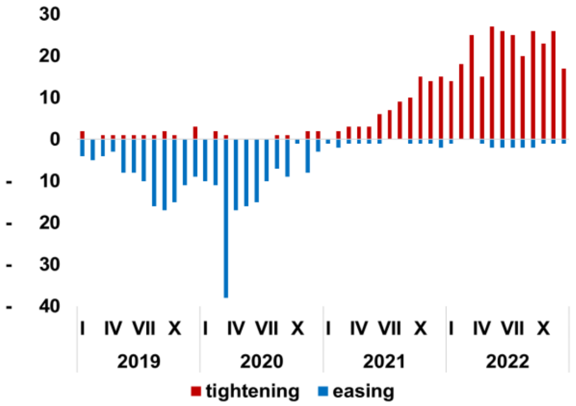
Meanwhile, since the Fed began to take measures earlier than other leading countries, there was a sharp increase in the dollar index and a depreciation in the national currencies of other countries during the year. In the coming quarters, due to expectations of a slowdown of the tightening phase by the Fed and key rate hikes by other leading countries, the dollar index is projected to

Figure 1.1.1. Global inflation (annual percentage)



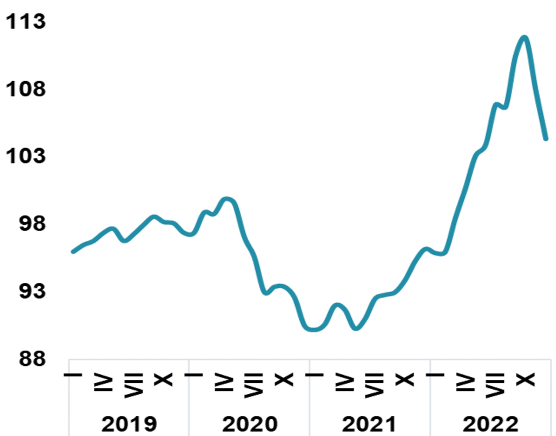
Source: Central Bank (hereinafter CB) calculations based on State Statistics Committees' data

Figure 1.1.2. Number of Central Banks which changed monetary conditions



Source: CB calculations based on data of the respective Central Banks

Figure 1.1.3. Dynamics of the dollar index



Source: CB calculations based of World Bank data decline, and national currencies are expected to recover against the US dollar (Figure 1.1.3).

Key rate hikes by almost all countries have a negative impact on economic activity and increase the risk of a recession. These concerns are reflected in the index of business activity, and business sentiment in major economies is becoming pessimistic (Figure 1.1.4).

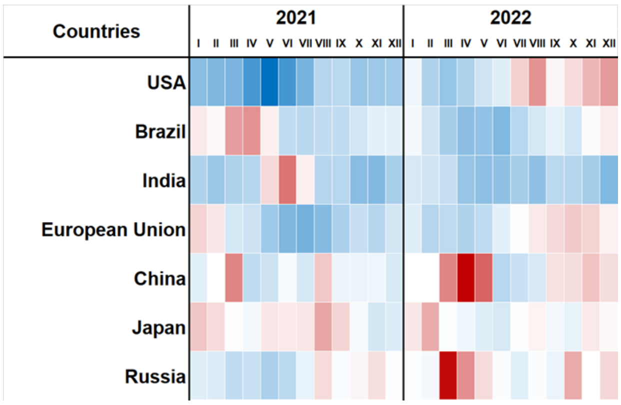
Along with that, international financial institutions assume the possibility of a recession in their forecasts. In January this year, the World Bank's projection on global economic growth for 2023 was lowered to 1.7 percent, whereas according to the International Monetary Fund real global growth is projected to amount to 2.9 percent *(previous forecast was 2.7 percent).* The difference between the forecasts is related to the increased risks and uncertainties, as well as the scale of the process of "economic opening" in China (Fig. 1.1.5).

Due to the tightening of monetary policy in the world and a decline in aggregate demand and economic activity there was a price decrease in energy resources, food and other raw materials in the IV quarter of 2022 (Figure 1.1.6). This, in turn, served to reduce global inflation rates. This trend is expected to continue in 2023.

Meanwhile, given the risks of recession in developed countries, investors' expectations of a slowdown in Fed policy tightening, as well as high demand for gold by central banks, the price of gold in the last quarter of 2022 averaged around 1,700-1,800 US dollars per troy ounce, reaching 1,814 dollars by the end of the year (Figure 1.1.7).

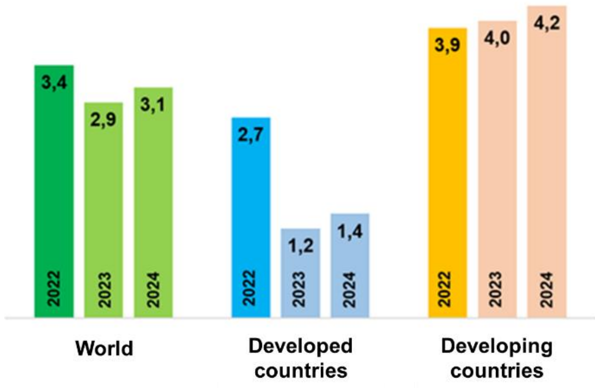
Consensus forecast of analysts of major investment banks and gold experts on

Figure 1.1.4. Purchasing Managers' Index



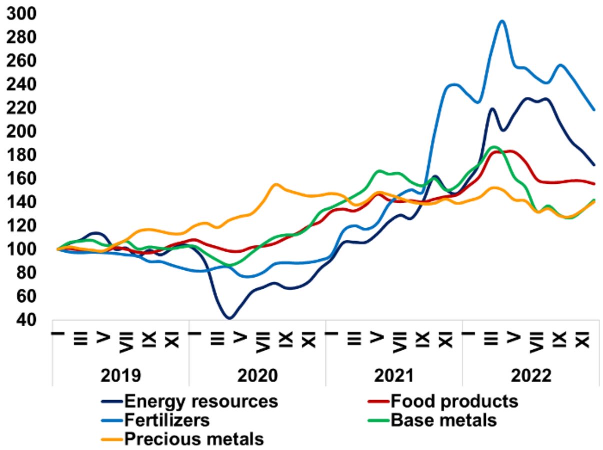
Source: S&P Global.

Figure 1.1.5. Prospects for global economic growth



Source: IMF, January, 2023

Figure 1.1.6. Dynamics of prices for energy resources, raw materials and food products (index, 2019=100)

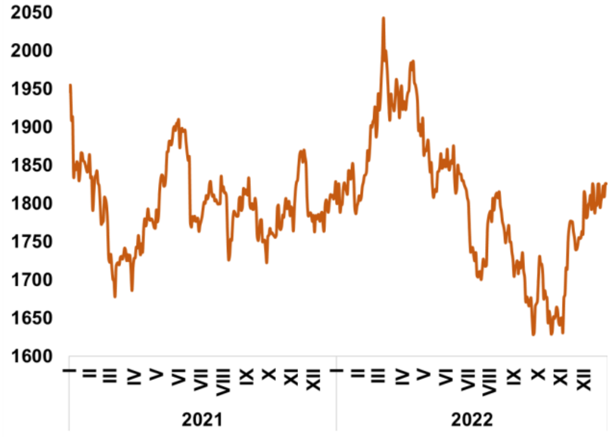


Source: CB calculations based of World Bank data gold price amounts to 1,850-1,900 dollars per troy ounce in the first quarter of 2023.

Weakening demand and pessimistic expectations resulted in a significant decrease in logistics costs (Figure 1.1.8). Even though supply chain disruptions are gradually being eliminated, they continue to negatively impact on global trade.

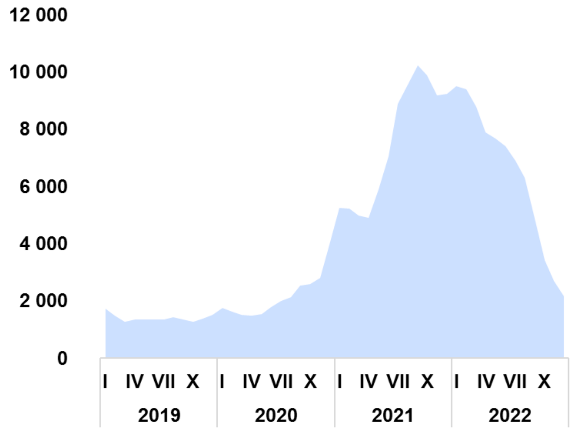
Overall, after a long and continuous increase in prices, in the fourth quarter of 2022 the global dis-inflationary environment was prevailing. However, inflationary risks and possible pro-inflationary factors persist.

Figure 1.1.7. Dynamics of gold price
(US dollars/ounce)



Source: gold.org

Figure 1.1.8. World Container Index
(US dollars)



Source: Drewry World Container Index

1.2. Economic environment in the major trading partners

In the IV quarter of 2022, economic and financial relations with our major trading partners developed more favorably than expected. In particular, foreign trade turnover continued to grow, and the volume of remittances to the country maintained high dynamics. The geopolitical situation that emerged last year caused restructuring of foreign economic relations and coordination of logistical directions in international trade. Despite temporary inflationary and devaluation pressures in our major trading partners, there were no negative changes in foreign trade trends.

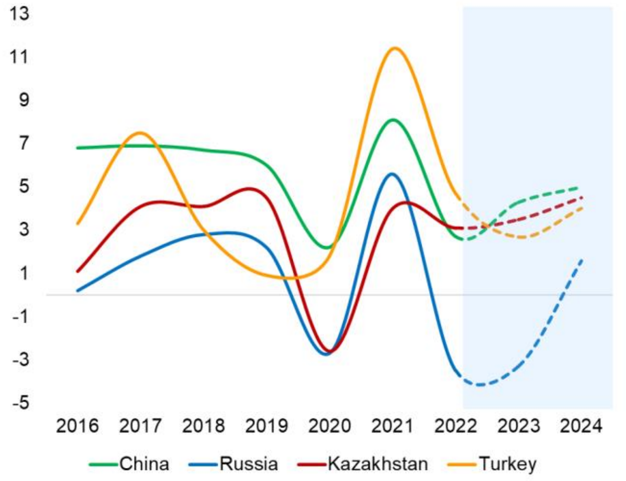
China. China's economy slowed down in 2022, and the growth rate was lower than the average indicators of recent years (Figure 1.2.1). The slowdown in economic growth was a result of the "Zero-Covid" policy of the Chinese government and the deterioration of the situation in the real estate market. Meanwhile, limited demand contributed to relatively low inflation (Figure 1.2.2).

In order to support the economy in China, monetary conditions were maintained "relatively loose" (Figure 1.2.3). A slowdown of the economy, pessimistic expectations of investors and an increase of the dollar index were reflected in a depreciation of the national currency (Figure 1.2.4).

Further, the lifting of quarantine measures and the easing of the pandemic situation in China will help economic growth recover, stabilize the exchange rate, and maintain inflation at current levels.

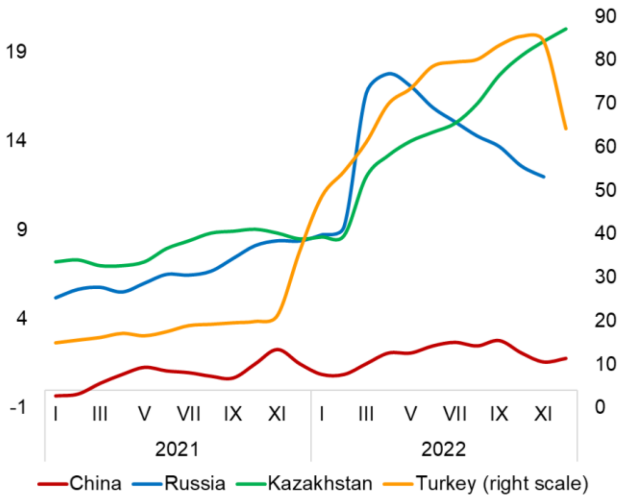
Given the huge role of China in the world economy, the "Zero-covid" policy reversal and the recovery of economic activity will have a significant impact on global economic indicators. Lifting of quarantine restrictions in January of this

Figure 1.2.1. Economic growth rates in major trading partners



Source: IMF, January, 2023

Figure 1.2.2. Inflation in major trading partners (annual percentage)



Source: State Statistics Committees of respective countries year is the main reason for the difference in the global forecasts of the World Bank and the IMF for this year.

Also, the recovery in China may put upward pressure on the global markets of raw materials, including oil, and technology products (semiconductors, chips, etc.).

Russia. The Russian economy continues to face the pressure of sanctions. The previously predicted deep economic downturn formed more moderate, partly offset by higher domestic demand and oil prices. However, uncertainty about the continuation of the conflict with Ukraine and the scale of sanctions in the future raise expectations of slower economic growth in Russia.

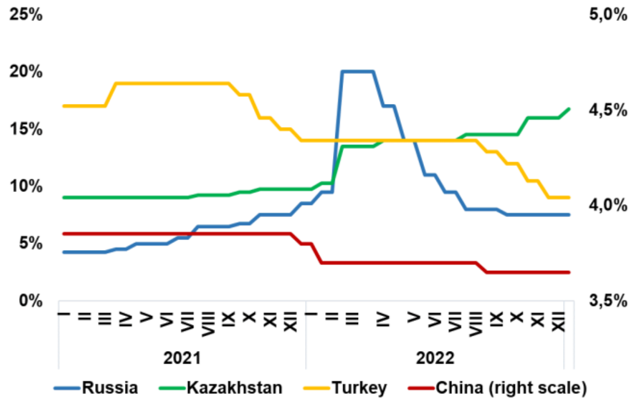
Inflation slowed by the end of the year after a spike in early 2022, and the Bank of Russia continued to ease monetary conditions. Since the impact of high inflation in the first quarter of last year is fading out, a significant decrease is expected in the first quarter this year.

Also, by the end of 2022, the exchange rate of the ruble depreciated to a certain extent due to the impact of a price decrease of oil products. The future trend will mainly depend on the price in the energy market.

According to the updated forecasts of the IMF, the Russian economy is projected to grow by 0.3 percent in 2023 due to high domestic demand, increase in military industry production and reorientation of oil exports to other markets.

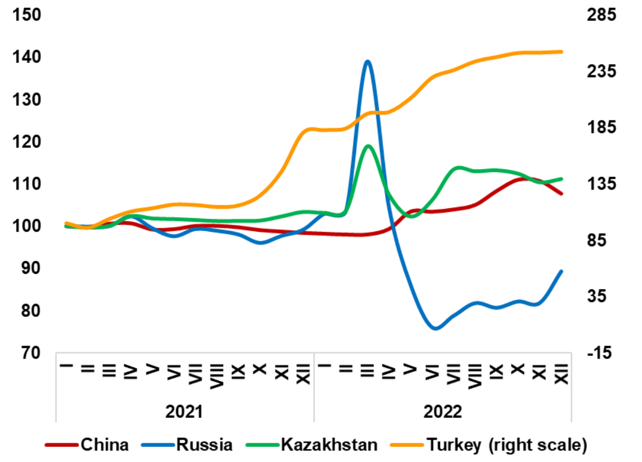
There will be no abrupt changes in foreign economic relations with Russia, and foreign trade is expected to remain in current trends. In turn, the migration situation in Russia, the exchange rate of the ruble and the expectations of economic growth increase the probability of continuing the current high volume of remittances to our country.

Figure 1.2.3. Dynamics of key policy rate changes on major trading partners (%)



Source: Central banks of respective countries

Figure 1.2.4. Change of exchange rate in major trading partners (%, 2021=100)



Source: Central banks of respective countries

Kazakhstan. The fact that inflation in Kazakhstan significantly exceeded the target corridor became the main problem for the country's economy, and in order to reduce it, in 2022 the regulator of Kazakhstan moved to the cycle of monetary tightening. The current monetary measures will help reduce overall inflation by curbing inflationary expectations in the future.

The current high prices for oil and the expectations on future growth of energy price due to the opening of China contribute positively to the forecast of Kazakhstan's economic growth.

Turkey. Turkey's overly loose monetary conditions and government support for the economy are stimulating economic growth. However, as a result of these measures, inflation is significantly higher than its target.

Meanwhile, investors' concerns about Turkey's economic stability are causing the national currency to depreciate. This year, the inflationary and devaluation situation in the country will depend on the policies implemented by the Government and the Central Bank. In doing so, due to the effect of a high base the inflation indicator can decrease this year.

Box 1

Forecast assumptions on external conditions

- In the first half of 2023, the global economy is expected to be somewhat volatile. This is due to the slowdown of economic activity as a result of the tightening of monetary conditions. Moreover, inflation is highly likely to continue downward trend.
  The external environment is expected to stabilize from the second half of 2023.
- High stock market risks expected by investors and continued weakening of the dollar index are factors for the formation of favorable gold price. Most analysts expect the price of the precious metal to average between 1,750 and 1,850 dollars per troy ounce during the year.
- Prices of oil and other non-ferrous metals, including copper, are projected to increase due to China's “opening” and the resulting high demand.
- Having risen sharply in early 2022, food prices (FAO index) then slowed down after a long correction. According to forecasts, the FAO index is expected to form around the current values.
- A gradual elimination of supply-chain disruptions and an increase in supply in the markets will partially offset the upward pressure on prices from the demand side.
- External economic relations with major trading partners will continue to develop steadily.
- Inflation will slow down in Russia, Kazakhstan and Turkey. By the end of 2023, the inflation is projected to amount to 5-6 percent in Russia,11-13 percent in Kazakhstan and 22.3 percent in Turkey. The inflation rate in China is expected to be around 3 percent.
- Due to price increase of oil and oil products, the exchange rates in Russia and Kazakhstan are expected to be relatively stable. The yuan is projected to relatively appreciate given investor sentiment and capital inflows. The Turkish lira will weaken slightly due to continued devaluation expectations and investor sentiment.
- There will be no significant adjustments in monetary conditions due to the central banks' expectations of the full effect of past monetary policy changes.

II. INTERNAL ECONOMIC CONDITIONS

2.1. Aggregate demand and production

In the IV quarter of 2022, aggregate demand in the economy remained high, and by the end of the year, the real growth of the GDP amounted to 5.7 percent (Figure 2.1.1). The main factors of high economic growth was a significant increase in household and government consumption.

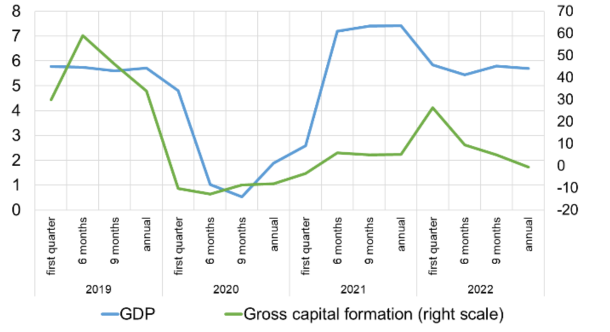
Also, a considerable increase in the amount of remittances to our country in 2022 (2.1 times more compared to 2021) was one of the important factors supporting household demand (Figure 2.1.2). This, in turn, was reflected in a significant increase in revenues from trade and financial services and the production of consumer goods in 2022 (Figure 2.1.3).

Last year, economic activity was mainly driven by an increase in the volume of gross consumption, while there was no significant change in investment activity. Particularly, the volume of investments in fixed capital remained at the level of 2021 in real terms.

In this case, the positive growth of non-centralized (private) investments and an increase of their share in total investments can have a positive effect on the overall efficiency of the economy in the future.

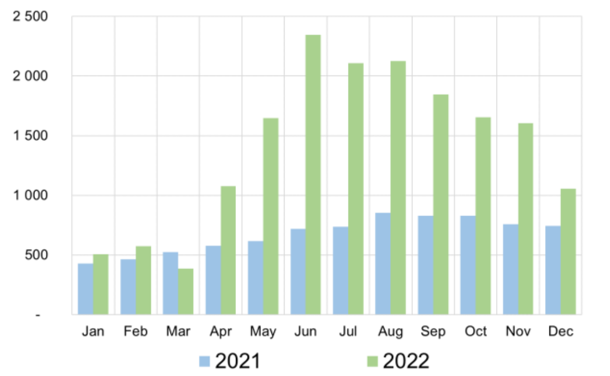
In the IV quarter of 2022, external economic processes were formed within the baseline scenario of the Central Bank's macroeconomic forecasts. In particular, due to an increase in foreign demand, the volume of exports continued growing at high rates. Also, in the context of a considerable increase of aggregate consumption, the import of consumer goods (food products

Figure 2.1.1. Real growth of GDP and gross capital formation, *in percent*



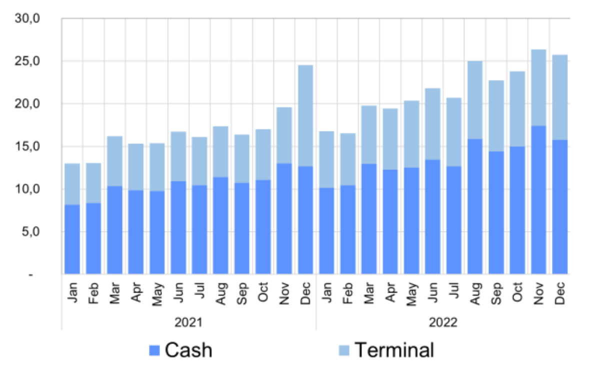
Source: Statistics Committee

Figure 2.1.2. Cross-border remittance inflow, *mln. dollars*



Source: CB

Figure 2.1.3. Trade revenues, *trln. soums*



Source: CB

and durable goods) rose significantly (Figure 2.1.4).

One of the main supply-side factors supporting the economic growth was a substantial increase in the volume of provided market services and construction works. Increased activity in services sector was mainly a result of the high demand of the population for trade, transport and financial services. In general, high growth in the services sector can be explained by the emergence of demand delayed during the pandemic and a low base effect (Figure 2.1.5).

The main factors of a positive growth of **the industrial sector** were the stable increase in the volume of production and processing.

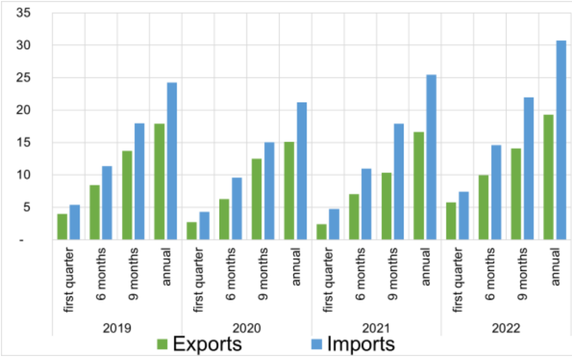
A strong growth in the real sector of the economy contributed to maintenance of the labor market relatively stable. This led to a significant increase in **average wages** in the economy in 2022 (Figure 2.1.6).

In the conditions of continuation of the current trends in **the real growth of population's income,** including **cross-border remittances, the aggregate demand** is expected to continue expanding strongly in the coming quarters. This can be one of the major factors putting **upward pressure on inflation** through affecting the balance of supply and demand.

That issue requires the Central Bank to maintain **relatively tight** monetary conditions as well as the Government to take measures in order to increase **the aggregate supply,** including increasing consumer goods production and facilitating import.

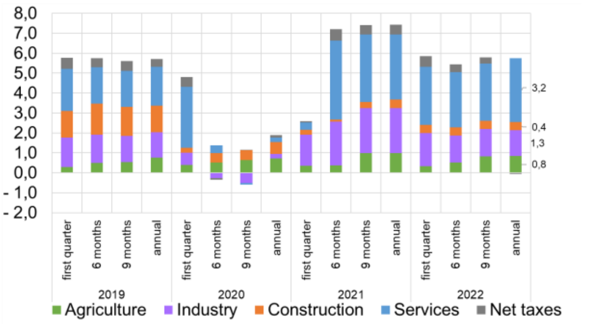
Due to the abnormal cold in January affecting some activity indicators, economic growth in the first quarter may be lower than last year.

Figure 2.1.4. Exports and imports, *bln. dollars*



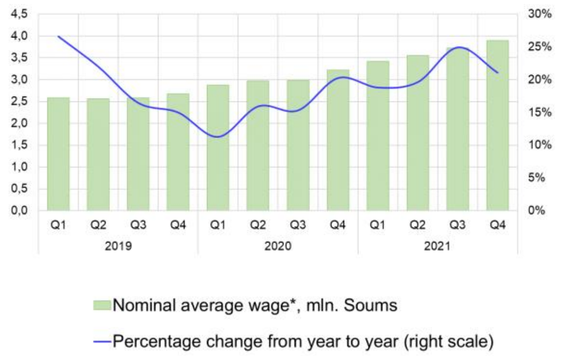
Source: Statistics Committee

Figure 2.1.5. Shares of economic sectors in GDP *(in percent)*



Source: State Statistics Committee, CB calculations

Figure 2.1.6. Average wage in the economy, *mln. soums*



Source: State Statistics Committee
** - Excluding agricultural sector and small business entities*

2.2. Fiscal sector

In 2022, the impact of **fiscal stimulus** implemented in previous years **on economic activity and investment processes** persisted. In doing so, according to preliminary data, the consolidated budget deficit at the end of last year amounted to about **4 percent** of GDP. The impact of fiscal incentives on economy is expected to persist in the first half of this year, and its future dynamics will depend on **the budget performance** in 2023 (Figure 2.2.1).

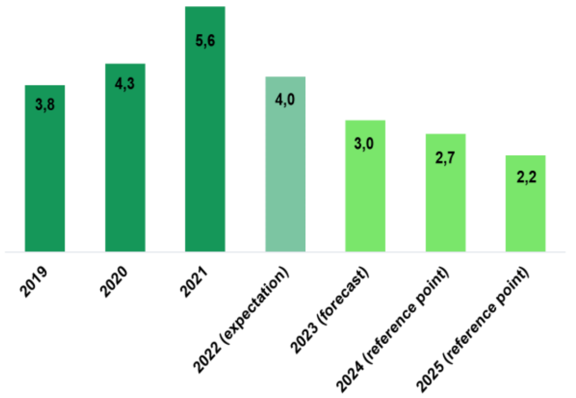
Last year, world price increase **on the main export goods** (gold, copper, natural gas) served to increase budget revenues. However, based on the objectives of ensuring social stability in the conditions of external economic uncertainty and high inflationary pressures, budget expenditures were also increased.

The budget consolidation expected this year will allow reducing the inflationary pressure of the fiscal policy in the second half of 2023 and further.

The dynamics of public debt remains stable. Tightened world monetary conditions constraints on foreign debt mobilization (Figure 2.2.2). Given that, the share of **domestic debt** in financing the budget deficit has been gradually increased, and this trend is expected to continue in 2023 (Figure 2.2.3).

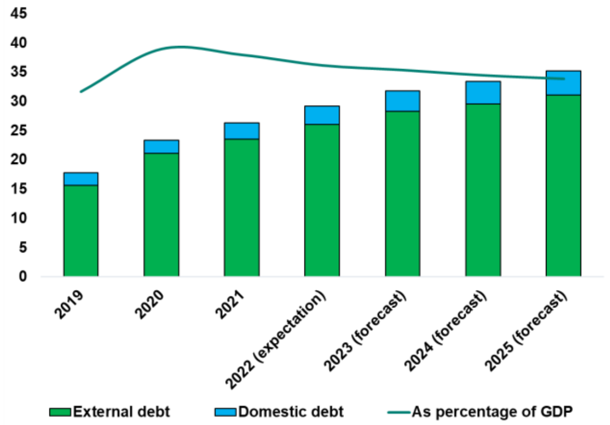
Maintaining public debt at a sustainable and safe level in the future will be important in ensuring macroeconomic stability.

Figure 2.2.1. Consolidated budget deficit to GDP *(in percent)*



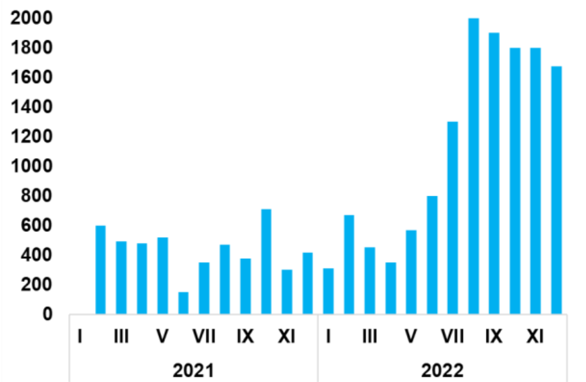
Source: Ministry of economy and finance

Figure 2.2.2. Public debt dynamics *(bln. dollars)*



Source: Ministry of economy and finance

Figure 2.2.3. Issuance of government securities in the domestic market *(bln. dollars)*



Source: Ministry of economy and finance

2.3. Inflationary processes

Starting from February 2022, in the face of worsening external conditions, inflation in our country accelerated *(Appendix 1).* The annual rate of headline and core inflation amounted **to 12.3 percent** and **13.8 percent,** respectively, by the end of 2022 *(Figure 2.3.1).*

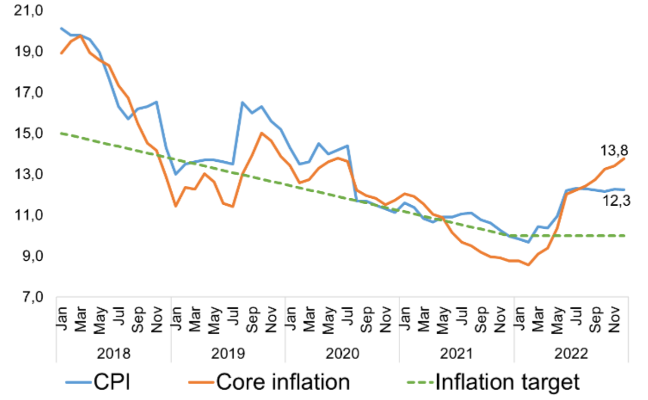
A high increase in the prices of basic foodstuff and imported goods caused the core inflation to rise sharply. Increased contribution of the core inflation to the overall indicator means that the inflationary pressures are **longer term** *(Figure 2.3.2).*

High core inflation of recent months requires maintaining **relatively tight** monetary conditions. In this regard, the **measures** taken by the Central Bank together with the Government are aimed **at reducing inflation to the projected level** by the end of the year and **achieving the target of 5 percent** in 2024.

High inflationary pressures in the economy, increased prices of fuel and energy resources, basic food products and imported raw materials led to the return of **inflationary expectations** to growing dynamics in the 4th quarter of 2022 *(Figure 2.3.3).*

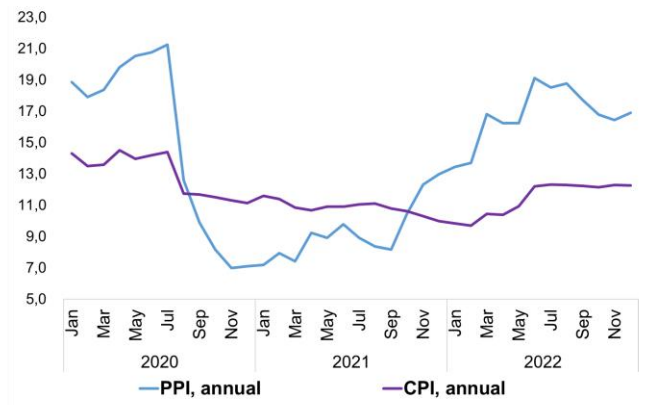
Higher inflationary expectations of the population will adversely affect **actual inflation in the future period.** In order to prevent spiraling inflation, effective monetary policy measures will be taken and communication policy aimed at curbing expectations will be implemented.

Figure 2.3.1. Headline and core inflation rates *(annual percentage)*



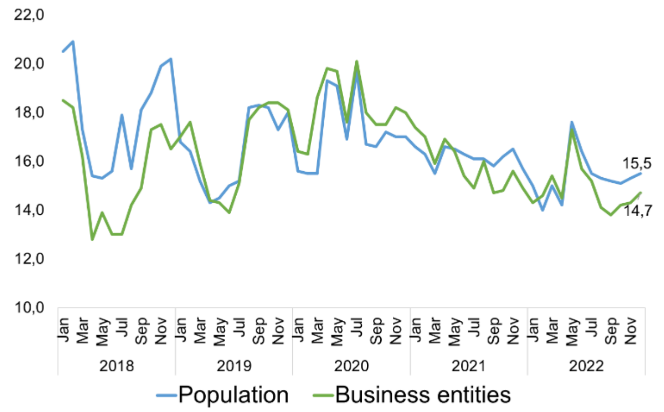
Source: State Statistics Committee, CB calculations

Figure 2.3.2. Inflation rate *(in percent)*



Source: State Statistics Committee, CB calculations

Figure 2.3.3. Inflation expectations for the next 12 months *(in percent)*



Source: Survey by CB

2.4. Monetary conditions

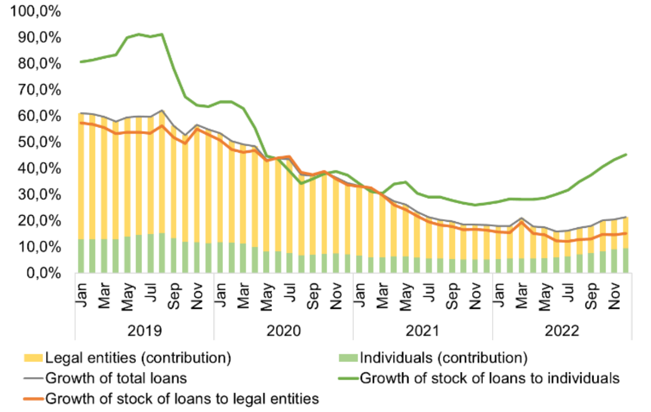
In the Q4 of 2022, in the context of keeping policy rate by the Central Bank unchanged **at 15 percent per annum** and the formation of the annual inflation rate slightly above 12 percent, **monetary conditions** were **"relatively tight".** Due to the pass-through effect of policy rate decisions on the money market and banking system interest rates **high real positive interest rates** on deposits in national currency were ensured in the economy. These real rates were at positive level of **4-5 percent** even compared to the population's inflation expectations. As a result, households' savings activity increased, and the volume of term deposits in national currency rose **by 1.6 times** by the end of the year *(by 1.7 times in 2021).*

In turn, interest rates on loans were balanced **at around 21-23 percent,** and loans to the economy grew in proportion to the nominal GDP growth *(by 21.4 percent annually).* Meanwhile, loans to individuals increased by 45 percent and were one of the factors supporting consumption *(Figure 2.4.1).* Since the share of loans to individuals in the total loans is relatively low *(25 percent)* they are likely **to continue growing at a high pace** in the coming years.

In addition, **the real effective exchange rate appreciated** in the Q4 due to the favorable external conditions, in particular, high export revenues and remittances, inflationary and devaluation processes in the major trading partners *(Figure 2.4.2).* This also contributed to tightening of monetary conditions and curbing inflationary pressures to a certain extent.

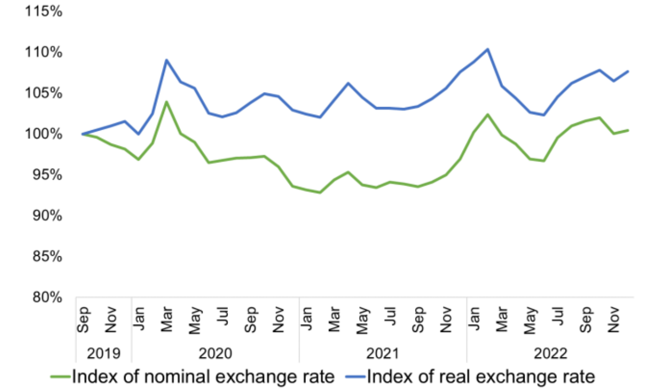
Monetary conditions are expected to be kept **relatively tight** this year, on the one hand, by taking necessary measures on monetary instruments, on the other hand, through appreciation of the real effective exchange rate as a result of continuation of the current trend in **currency inflows** *(Fig. 2.4.3).*

Figure 2.4.1. Annual growth of loans to individuals and legal entities *(in percent)*



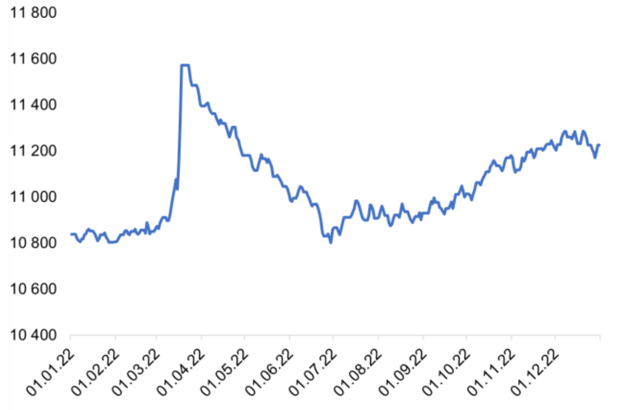
Source: CB

Figure 2.4.2. Indices of nominal and real exchange rate, *(September, 2019 = 100%)*



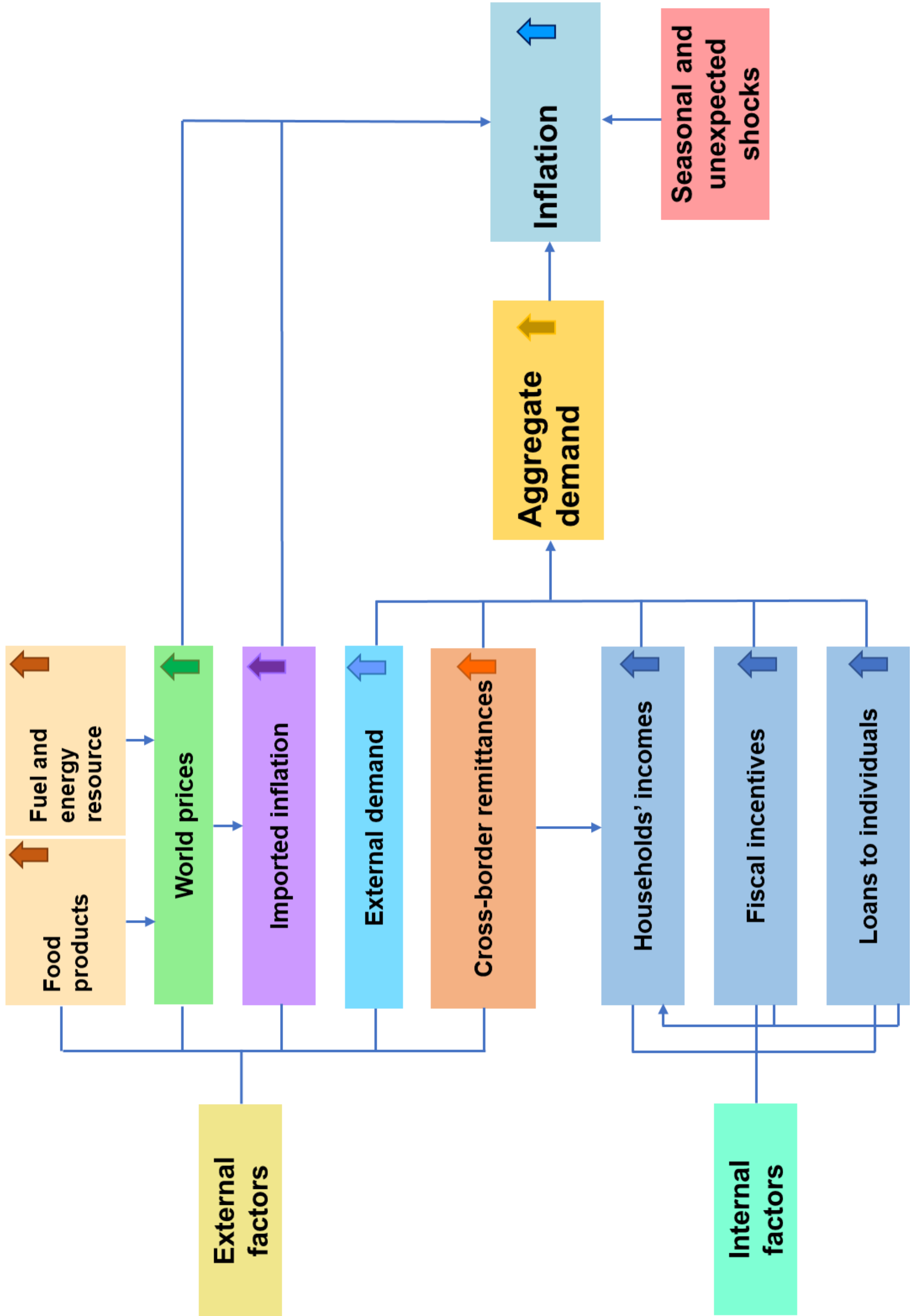
Source: CB

Figure 2.4.4. Dynamics of exchange rate, USD/UZS



Source: CB

Appendix 1


Inflation
Seasonal and unexpected shocks
Aggregate demand
Fuel and energy resource
Food products
World prices
Imported inflation
External demand
Cross-border remittances
Households' incomes
Fiscal incentives
Loans to individuals
External factors
Internal factors

III. MEDIUM-TERM MACROECONOMIC PROJECTIONS

3.1. Expected internal economic processes

In the recent three years the global economy has been formed in the context of **high uncertainties** *(Figure 3.1.1).* While **negative effects of the pandemic** are diminishing, there are risks and uncertainties regarding **the geopolitical situation** that began in February last year and its effects on the global economy.

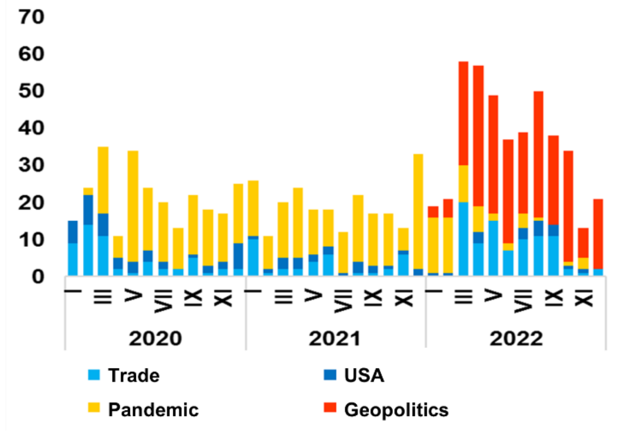
Although this situation make designing macroeconomic forecasts **difficult,** the importance of assessing the impact of possible risks on the economy and **taking effective measures** in advance is increasing.

The Central Bank has updated its forecasts based on the internal and external economic conditions at the end of 2022, statistical indicators, future risks and their possible impact on our economy. **The main assumptions** on these forecasts are the expected economic slowdown, possible recession, stabilization of inflationary processes, continuation of geopolitical tension and maintenance of the current trend of external activity *(Box 1).*

According to the updated forecasts, in the next quarters the main macroeconomic indicators are expected to develop **within the baseline scenario** presented in the Monetary Policy Guidelines for the period of 2023-2025.

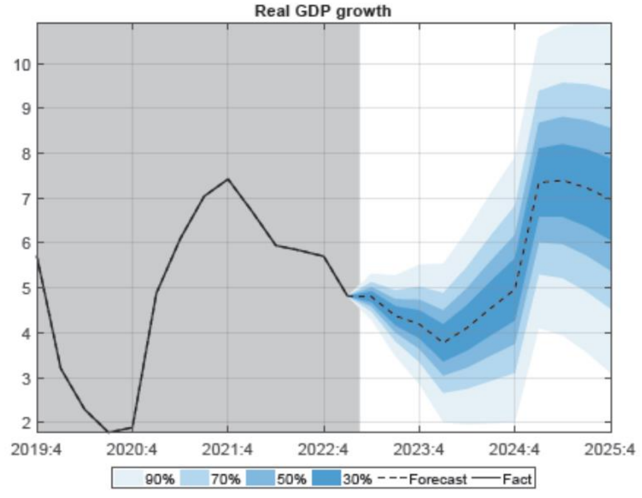
In particular, real GDP growth is expected **to slow down marginally** in the first quarter this year and to amount to around **4.5-5 percent** by the end of the year *(Figure 3.1.2).* Expected economic slowdown in the first quarter is explained by **seasonal factors,** including a slight decrease in economic and consumer activity at the beginning of each year, and the impact of **abnormal weather conditions** on

Figure 3.1.1. Major uncertainties in the global economy (as percentage)



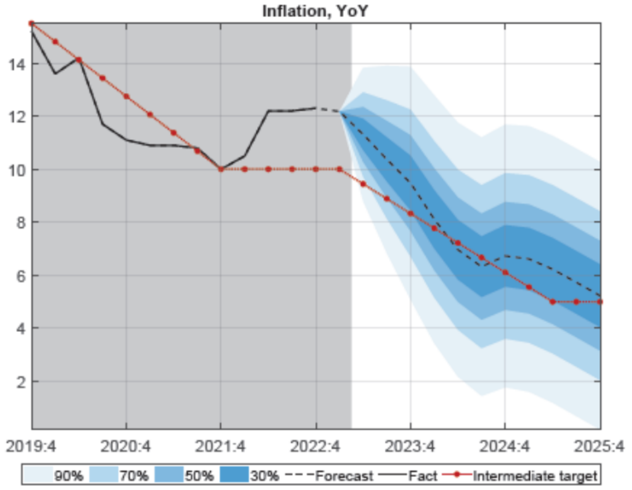
Source: IMF

Figure 3.1.2. Real GDP growth



Source: CB

Figure 3.1.3. Inflation forecast



Source: CB

production processes. However, this **“negative output gap”** is expected to close in the following quarters due to an increase in activity and effective measures of the Government **to further support the economic sectors.** However, the probability of **global economic slowdown** and **recession** in some countries is increasing.

As a result, the economic growth in almost all our major partners is expected **to be lower** this year, that can be reflected in the economic growth of our country through a number of **channels** *(such as remittances, export revenues, foreign trade restrictions, capital flows and investments).*

Given the above, increasing the volume of private and foreign investments and their efficiency, enhancing production potential and providing necessary resources in the economy is crucial **to ensure high economic growth** this year.

Overall, according to updated forecasts **the GDP gap** (the difference between actual output and potential GDP) is expected to widen negatively this year and close in the coming years. This **negative gap** can have a **reducing** effect on inflation, and the conditions of aggregate supply and demand in the economy have an important role in the meantime.

However, **high fiscal stimulus** of previous years means that upward pressure on inflation will remain this year through supporting domestic consumption.

On the other hand, the high growth rates in **remittances** to the country in 2022 and their expected volume this year as well may put upward pressure on aggregate consumption and, accordingly, on an inflation rate through increasing **the households’ income.**

In general, the uncertainties regarding **supply factors** since the beginning of this year, the current high dynamics of **core inflation** and production prices may cause the inflation rate to be higher than the forecast corridor in a short period of time.

Based on the above, the inflation rate is expected to be around **8.5-9.5 percent** at the end of 2023 (Figure 3.1.2). The following factors contribute to decreasing of the inflation rate compared to 2022:

- the fact that **the global inflation** has shifted to a decreasing trend, in particular, a decline in the prices for **basic food products** (FAO index), and, accordingly, price stabilization in our major trading partners compared to last year;
- **overall fiscal deficit** will be lower this year compared to previous years, and its impact on inflation will gradually decrease through the reduction of fiscal incentives;
- the current dynamics of inflation and its forecast for the next period require maintaining **“relatively tight” monetary conditions** in the economy. In doing so, **real positive interest rates of at least 2-3 percent** will be ensured in the money market by taking necessary decisions on the policy rate during the year. Additionally, **appreciation of the real effective exchange rate** due to the current trend in currency inflows, is a factor reducing inflation through tightening the monetary conditions;
- some of the inflationary pressures that emerged last year is expected to fade out and prices in the world market will balance, that also will serve to reduce the inflation rate.

3.2. Balance of payments and foreign economic activity

Large-scale structural reforms and increased investment activity in the economy resulted in **a wide trade deficit** in recent years. In this case, the import of investment goods, including machinery and equipment *(about 40 percent of total imports)* has a critical role.

The trade balance, creating a high deficit **in the current account,** was partly covered by cross-border remittances. However, in 2022, according to preliminary estimates this deficit was offset by a sharp increase of remittances *(Figure 3.2.2).*

The current account is predicted to be relatively balanced in 2023 due to continuation of the current dynamics in remittances, the growth of exports at a higher rate than imports.

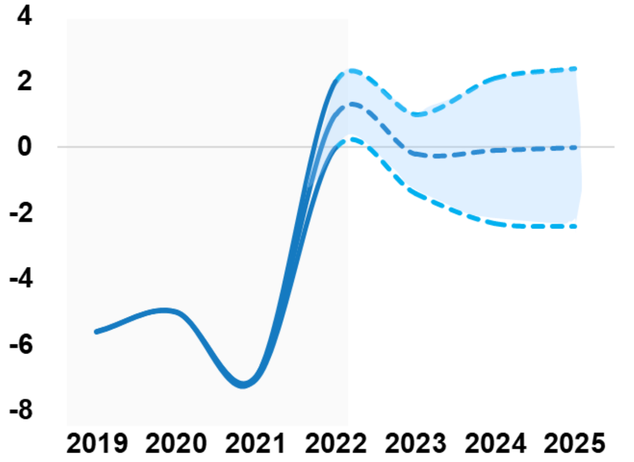
Meanwhile, the stabilization of foreign economic conditions, the relatively stable exchange rates in the country9 and major partner economies, as well as sustained high world prices on our main export goods will serve to **increase exports**.

Moreover, **increasing FDI inflows** due to the continuation of structural reforms is expected to be reflected in the upward dynamics of imports.

Global financial conditions will be maintained tight. In particular, the Fed rate is projected to be **around 5 percent** and yields on Treasuries is expected to be high. Europe and other leading countries will continue to tighten monetary conditions in order to reduce inflation, which is still high.

As a result, **foreign debt affordability** is expected **to be limited,** and the volume of government bonds issued to the domestic market will increase. According to the Ministry

Figure 3.2.1. Current account to GDP
(in percent)



Source: CB calculations

of economy and finance, bonds of 16 trillion soums are planned to be issued in order to attract domestic debt.

In their turn, commercial banks, as in 2022, will carry out asset operations mainly at the expense of **internal resources.**

In addition, the country's **risk premium** also significantly affects the cost of borrowing foreign debt. In 2022, due to the geopolitical situation in the region, there was a sharp increase in the yields on our Eurobonds, which balanced out until the end of the year.

This year **the risk premium** is expected **to slightly decline,** and internal economic processes, relations with foreign partners, policies implemented, including monetary policy measures aimed at reducing inflation, can be factors decreasing the cost of external borrowing.

This Report prepared by Monetary Policy Department.

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