

THE BASIS OF MONETARY POLICY IMPROVEMENT OF THE CENTRAL BANK OF THE REPUBLIC OF UZBEKISTAN

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Abstract: *Monetary policy plays an important role in the economy of any state. Like many other countries, the Central Bank is defined as the implementer of this policy in the legislation of Uzbekistan. Today, not only the state, but also the entire world economy is growing rapidly. This will require the Central Bank of the Republic of Uzbekistan to adjust its approach to monetary policy in a timely manner.*

Keywords: *Inflatable targeting, dollarization, baseline and alternative scenarios, price stability, inflation expectations of households and enterprises, broad money.*

INTRODUCTION

The possibility of independent monetary policy (MP) in Uzbekistan arose in 1994 after the introduction of national currency into circulation. We have divided the work done from 1994 to the present day into two periods. The first period covers 1994-2017. During this period, monetary targeting was chosen as a mechanism of MP and aimed at ensuring the stability of the national currency by preventing a sharp increase in the mass of money. This, in turn, would allow the Central Bank (The CBU) to improve MP by focusing on price stability in the domestic market. Although during this period, the exchange rate of the national currency was gradually devalued by linking it to the dollar, this mixed mechanism later proved its ineffectiveness as a result of external shocks. We should emphasize that the main reason for this is that problems in the domestic currency market and factors such as monitoring the mass of money in development conditions and the weak link between interest rates and demand for money, high dollarization rates have reduced the ability to determine demand for money, which has reduced the CBU's reliance on MP, resulting in several difficulties for the CBU itself. The second period covers measures that have been implemented

from 2017 to this day. In the first 2-3 years, fundamental foundations were created for the transition to inflatable targeting (IT) regime in the country. The transition to this regime in Uzbekistan began to be carried out at a rapid pace in 2020. Proof of this can be seen in the fact that in January 2020, the CBU adopted an official IT strategy set as the goal of switching to IT and reducing inflation by 10 percent by the end of 2021 and 5 percent by the end of 2023.

MATERIALS AND METHODS

The article used systematic analysis, statistical, economic and scientific abstraction, comparative and content analysis, and a number of other methods. Also, the fact that in the first period the currency exchange rate targeting regime was applied to the operation, this method showed several results. We can describe these as follows: Firstly, because of the simplicity of this regime and the fact that it is all clear in this, ordinary people, legal entities, are also easily understood by participants and subsidiaries in the marketplace. Secondly, it prevents the rate of inflation from growing rapidly during times of economic crisis. This will result in an effective decrease through this regime.

Currently, the CBU has provided its baseline and alternative scenario to the public on its website. And implementing this scenario covers 2023-2025. The regulator noted that the process of IT in MP will continue, noting that the focus will be on achieving price stability in the economy.

The most important aspect of this was that the management of the CBU approved a review of "Monetary policy guidelines for 2024 and the period of 2025-2026."

According to the CBU, constant growth in the interest rates of central banks attract resources from foreign markets. Increasing the cost of creating and servicing debt and, as a result, the economy in most developing countries simultaneously increases the activity of the financial system, which leads to increased risks to its stability.

The macroeconomic development scenarios developed to identify key aspects of MP for the next period are based on the above-mentioned factors and assumptions and forecasts on their impact on the domestic economy.

Taking into account the current state of the CBU in terms of external conditions and uncertainty and their impact on the domestic economy, the CBU has developed its baseline and alternative scenarios, taking into account two main medium-term macroeconomic developments.

In the baseline scenario, we attach special attention to the following conditions. At the same time, at a high rate of economic activity in the country, the growing dynamics of investment and consumer demand are aimed at maintaining the current level of rigidity of monetary conditions. The formation of regulated prices, on the other hand, is aimed at a slight softening of monetary conditions and transfer to a "neutral

phase" in case of strong confidence that inflation will achieve its targeted forecast. And this process - gradually adapts to market mechanisms. And as a result, fiscal consolidation begins. Also, due to the reduction of state intervention in the economy and the continuation of established structural reforms, the competition will improve, and the volume of private investment will also grow at a high rate.

Against the backdrop of external risks and increased global recession, the alternative scenario is based on the likelihood of a decrease in the country's external demand levels, a decrease in currency flows through various channels, production under the influence of climate change, and a reduction in gross offer.

In this situation, if a decrease in gross demand is a factor that maintains global inflationary processes and reduces the prices of raw materials, the reduction in gross offer has a negative impact on the level of prices in the domestic market.

According to updated forecasts within this scenario, the period of achieving a permanent 5 percent target of inflation is set to be in the second half of 2025, taking into account the fact that the pressure on proposal factors of changes in the external situation between 2022 and 2023 remains longer and the impact of certain regulated price adjustments on overall inflation.

Also, the extension of the target reach period is due to the delay in adequately meeting domestic consumer demand of the gross offer in the economy on the one hand, while on the other hand, it can pose serious risks to economic activity and financial stability in the event of sharp measures aimed at restraining gross demand.

As part of the baseline scenario for macroeconomic development, the inflation rate is projected to be around 8-9 percent in 2024. Monetary conditions will also be maintained at a relatively strict phase in 2024 to ensure that inflation is at this level.

Many economists have held different negotiations on the role and importance of MP in ensuring public finance and stability. Representatives of different nationalities have carried out scientific research on this issue, publishing articles and monographs. Still today, however, this topic is causing widespread discussion by a number of other economists and practitioners and has been at the center of the discussion. The importance of MP in ensuring the stability of the state is also reflected in the scientific work of foreign economists. For example, Mr.Nils Maehle also expressed his views on MP through his scientific paper on "Monetary Policy Implementation: Operational Issues for Countries with Evolving Monetary Policy Frameworks." At the same time, we can see that with his work, Mr.Nils Maehle also paid attention to the importance of MP in maintaining the stability of public finances. In addition, several websites have published articles and scientific research on the importance of MP under different names by various authors.

DISCUSSION

Meanwhile, due to the level of regulated price adjustment in 2024, the forecast for inflation can be revised up and monetary conditions changed, respectively. In improving the effectiveness of MP, measures will continue to reduce the level of dollarization in the banking system, reduce privileged lending practices, and switch to interest rates based on market principles. As part of the baseline scenario, the forecast for real gross domestic product growth in 2024 is expected to be around 5-5.7 percent, while 5-6 percent in 2025 and 5.5-6.5 percent in 2026 are forecast. In the alternative scenario, unlike the baseline scenario, the inflation rate is expected to be around 9-10 percent in 2024, given that the slightly poor formation of external conditions will create additional pressure on domestic prices. In this condition, the period of achieving a permanent target is forecast to be delayed for a longer period, with inflation of around 7-8 percent in 2025 and a decline of up to 5 percent by the end of 2026. Fiscal incentives will be the main factor supporting economic activity within this scenario. At the same time, in the medium term, real growth of GDP could be 1.5-2 percent lower than forecasts presented in the baseline scenario. Recognizing that the effectiveness of IT depends in many ways on the effectiveness of the MP interest channel, the main focus in foreign countries is on developing the financial system and ensuring stability.

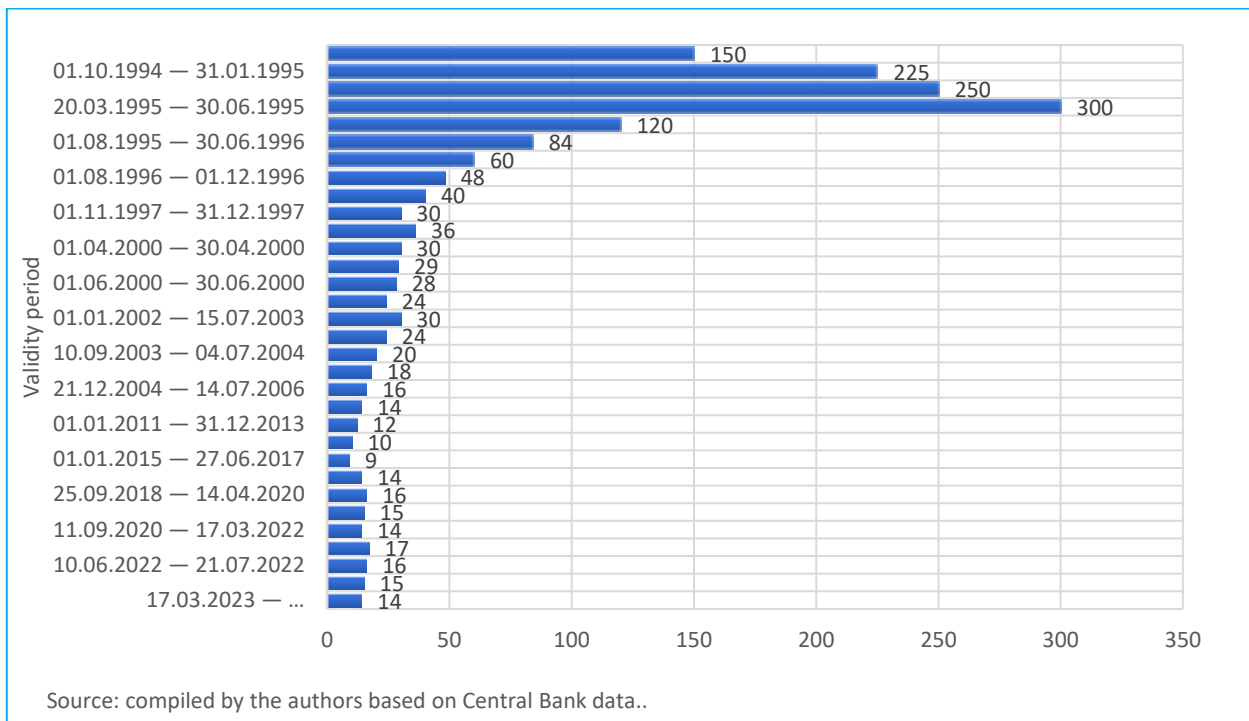


Figure 1. Policy rate (%)

On March 17 this year, the CBU reduced policy rate from 15% to 14%, which was explained by ensuring that interest rates in the money market are formed at a level close to the central bank's interest rate. The CBU's measures should be prioritized in

the development of an open market operations strategy, as defined in the guidelines of MP.

Market mechanisms play an important role in improving MP. Regarding the transfer of credit to market mechanisms, the President of Uzbekistan, Shavkat Mirziyoyev said: "I understand well that everyone wants to get cheap loans. However, if we artificially reduce loan interest rates, the balance in the money market will be broken. Therefore, we should not forget about macroeconomic stability so that we can lend cheaply to the economy. Without stability, we will not be able to achieve our goals for economic growth. In this regard, we will continue to work consistently aimed at reducing inflation and transferring the lending process through the bank to full market mechanisms."

The relevance of MP is increasing day by day. On November 15, the leadership of the CBU took part in the 11th Kazakh Congress of Financiers dedicated to the 30th anniversary of the national currency of Kazakhstan organized by the National Bank of Kazakhstan. Mamarizo Nurmuratov, chairman of the CBU, spoke at the event: "In the era of high uncertainty and volatility, the MP itself should not become a source of uncertainty. Every step of ours should be thoroughly checked, the signals should be clear and understandable. In our opinion, the main problems of price stability today are, on the one hand, the backwardness of some components of the domestic supply, and on the other hand, it is supported by the measures of the budget policy and, although it creates tension in the foreign exchange market, it is satisfied through imports. is an increase in domestic demand. In addition, the most important thing is the presence of limited transmission in MP. As I said, when the real interest rates are so high, working on increasing the efficiency of transmission plays a more important role than increasing the base rate".

RESULTS

The studied data showed that the institutional independence of the CBU was strengthened at a high level during the past period. According to the IMF's calculations, before the transition to the IT regime in the MP of the Republic of Uzbekistan (2016), the independence of the CBU recorded an indicator of 0.28 on a scale of 0-1, and this, in turn, prevented him from fully performing his function. After switching to the IT mode, by 2021 this indicator has increased to 0.92. The economic indicators representing the independence of the CBU were 0.72 and 0.64 scales for developed and developing countries, respectively. This analysis shows that Uzbekistan is making progress in fulfilling the initial conditions for the introduction of the IT regime, but there are still some shortcomings. The results show that the CBU has reduced most of the technical infrastructure problems and some of the institutional problems, but additional efforts are needed to strengthen institutional independence.

At the same time, there are still significant shortcomings related to the financial system and economic structures:

1. Technical infrastructure of the Central Bank;
2. financial system health;
3. Institutional independence;
4. Economic structure;

In addition, according to the analysis of the broad money, the money supply in the National currency continues to decrease. The reduction of money supply in the national currency continued in November. This is an atypical situation for Uzbekistan in recent years. During November, the money supply in the national currency decreased by almost 1.0 trillion sums and amounted to 153.6 trillion sums. The largest reduction in the composition of the money supply was due to cash in circulation (-2.7 trillion sums). As of December 1, the balance of cash in circulation is 45.5 trillion sums. The symbolic growth of the money supply in a broad sense to 201.3 trillion sums (+422 billion sums) was due to the nominal growth of foreign currency deposits. At the end of November, the balance of banks' funds in representative accounts increased to 15.8 trillion sums (2.1 trillion sums), but this is almost 5 trillion sums compared to the same period last year. The balance of mandatory reserves remains almost unchanged at around 2.8 trillion sums.

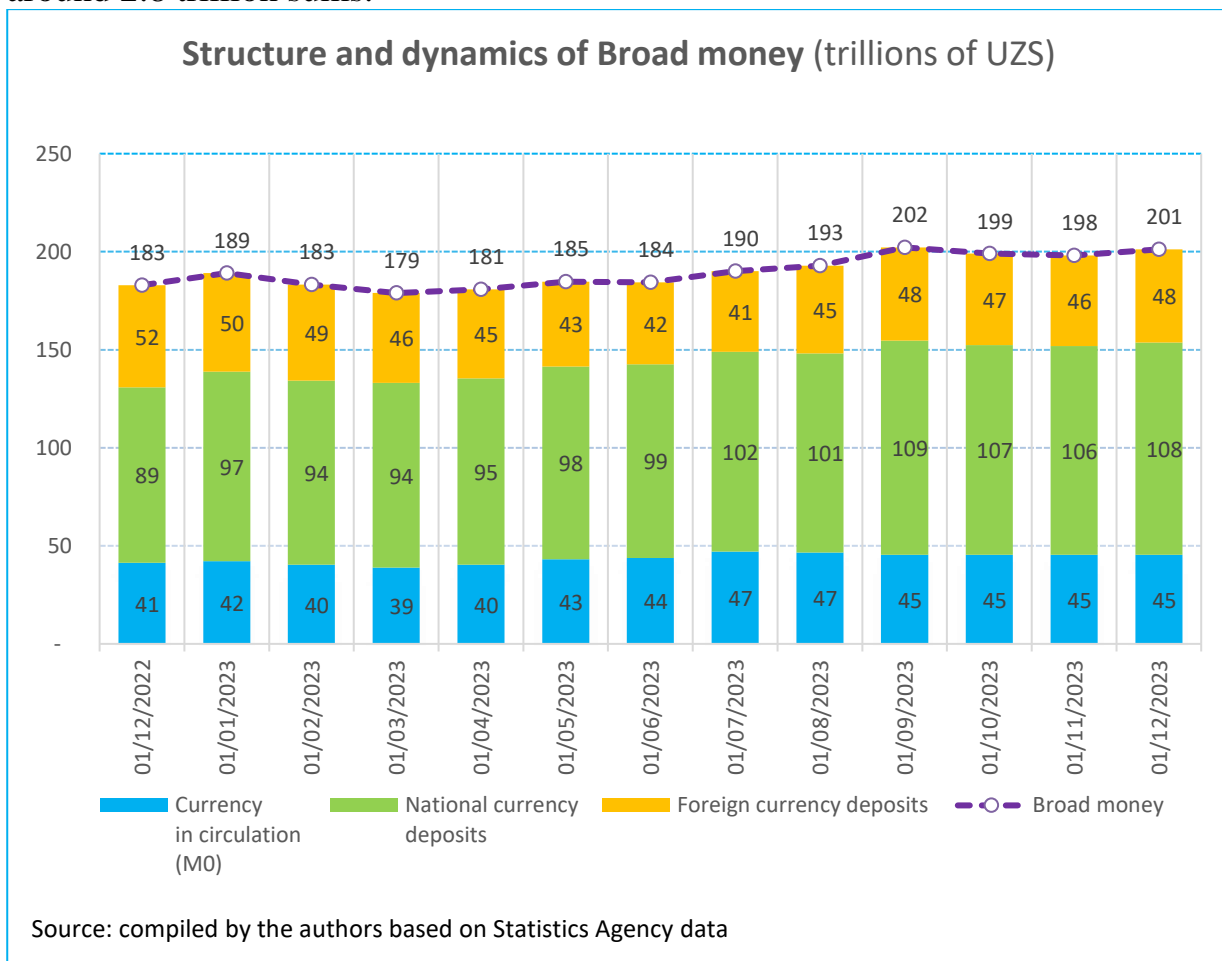


Figure 2. Structure and dynamics of Broad money (trillions of UZS)

Deposits in national currency reached 108.1 trillion sums as of December 1, which is a 21% increase compared to the same period last year. Encouraging deposits in national currency leads to a decrease in the level of dollarization. Also, the 1-year dynamics of cash in circulation increased by 9%, while foreign currency deposits decreased by 8%.

The channel of inflation expectations is one of the main factors that should be taken into account in the implementation of the MP within the IT regime. The channel of inflation expectations is of primary importance when the participants of economic processes take into account not only the real market conditions, but also the possibility of their future changes when making decisions. In particular, inflationary expectations are important for enterprises and entrepreneurs to set prices and assess future wage changes. At this point, the main feature of this channel is manifested in the formation of prices for products and services by enterprises and organizations. In this case, enterprises and organizations expecting an increase in the inflation rate in the future will raise prices, which will lead to an increase in the current inflation rate. The fact that inflationary expectations in the economy are at a high level compared to the target indicators of the central bank causes doubts in the society about the full control of inflation by the central bank. This situation may make it necessary to sharply increase the interest rate. During the period of structural changes and liberalization of the economy in the conditions of Uzbekistan, inflationary expectations may increase and remain for a certain period of time in the future. The transition to the IT regime requires increasing public confidence in the policy of the CBU expected to be implemented in the future and thereby achieving the formation of positive inflationary expectations.

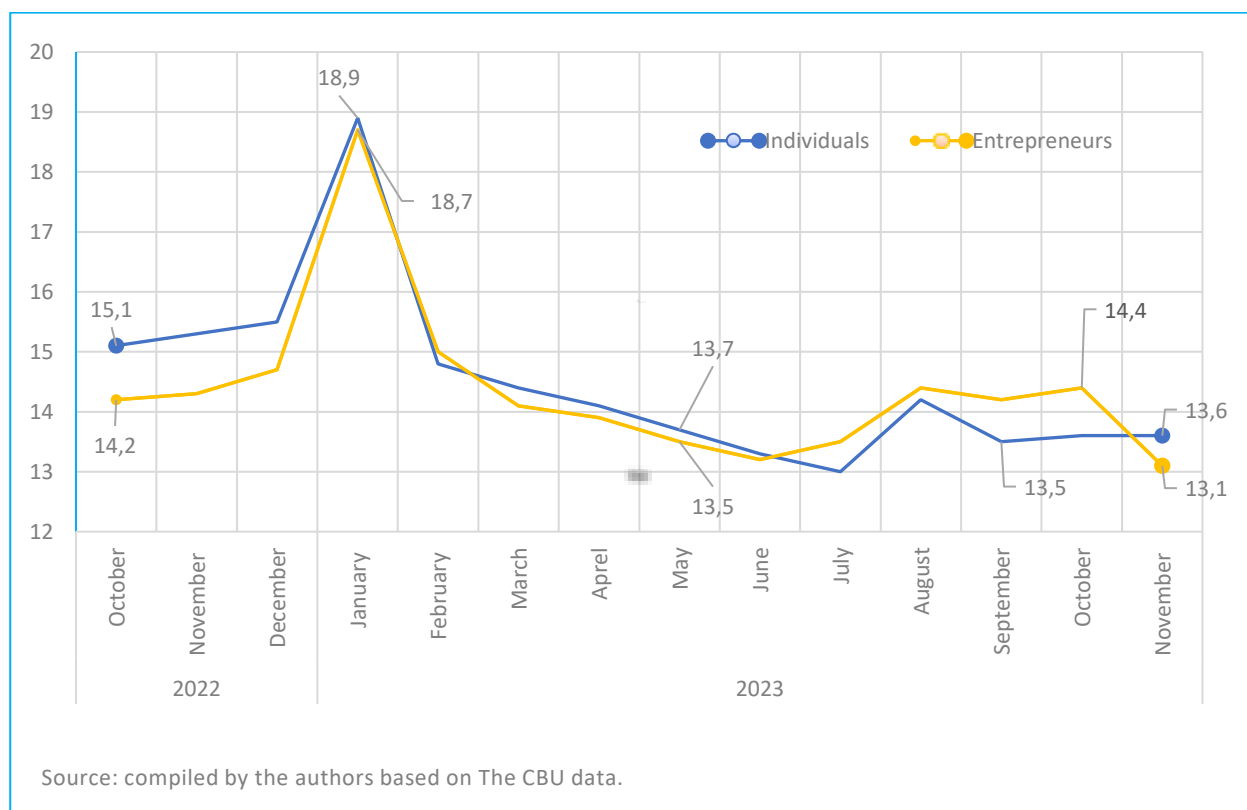


Figure 3. Inflation expectations of households and enterprises

In particular, the CBU conducts a monthly survey on inflation expectations of the population and business entities, and the final results are announced in the mass media. During the current year, inflation expectations reached the highest level in January: residents and businessmen estimated that the currency would depreciate by 18.8% on average. During the next month, both indicators had a downward trend and averaged 13.2%. By the end of the year, the population's expectations were 13.6%, and the expectations of business entities sharply decreased to 13.1% compared to October. For now, there is a 4-4.5% difference between expectations and the current inflation rate of 9%. Taking into account the inflationary expectations of the population and inflationary pressures in the economy, the MP will be kept at a "relatively tight" level throughout 2024, and it will be transferred to the "neutral phase" at the end of 2025, when there are grounds for achieving the inflation target.

CONCLUSION

In order to develop MP, not only MP should itself be improved, but it should be used other policies of CBU effectively in combination. "I must emphasize that we are seeing weak changes in the actions of our MP. This is primarily an unsatisfied demand and irrational behavior of agents. This appears to be a limited income, but at the same time, even with high interest rates, there is a lot of interest in loans. Here, of course, we need to take macroprudential measures to limit such actions aimed at increasing additional demand. We need to work with macroprudential measures that limit unsound financing and reduce risks to financial stability. The economy has been recovering from high budget deficits for the past three years, which has weighed on MP. And in such conditions, we will continue to adhere to the position of the need for fiscal consolidation, and in order to introduce a coordinated tax-budget policy in the context of growing economic activity, we need to gradually increase the voice of the monetary policy", - said Mamarizo Nurmuratov at the end of his speech in the 11th Kazakh Congress of Financiers.

A monetary policy based on well-developed macroeconomic forecasts reduces uncertainties in the domestic financial markets, facilitates the explanation of the nature of the decisions being made, and makes it possible to determine its directions in advance. Existing risks and obstacles make it difficult to implement the IT regime. On the other hand, the CBU focuses on strengthening the forecasting and analytical base, improving monetary and credit policy instruments and strengthening channels of influence, developing communication policy and increasing public confidence.

Taking into account the fact that communication is a software product in the mode of inflation calculation of the monetary and credit rate of the CBU, it is necessary to make sure to increase transparency and efficiency in monetary and credit communication next year. Central banks benefit from large-scale data and rely on

strong and influential empirical evidence in conducting macroeconomic management. Modeling and forecasting tools should be used to correct the fundamental factors of changes in the economy, and they should be continuously improved.

In addition, there are factors that limit the effectiveness of MP:

1. low level of effectiveness of interest rates in the money market in the formation of asset prices;
2. high dollarization of deposits, loans and liabilities in the banking system;
3. Preferential lending practices and unbridled inflationary expectations;

It is necessary to decrease these limiting factors in order to improve the basis of monetary policy of the Central Bank of the Republic of Uzbekistan.

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