WAYS TO IMPROVE THE MONETARY POLICY IN UZBEKISTAN

Azimov Shakhzod Qahhorovich
Independent researcher at Tashkent State University of Economics
shazimov@mineconomy.uz, Shoxbek@list.ru

Introduction

Improving the standard of living of the population today remains the main goal of the socio-economic policy of all modern societies. It should be noted here that the most important aspect of prosperity is undoubtedly economic growth.

Over the past few decades, economic perspectives have increasingly focused on the critical issues of socio-economic development, and the insufficient economic growth and vulnerability of developing countries to external shocks show that the development of effective macroeconomic policies is more important than ever. Implementing this requires national governments to find the best economic development policy without jeopardizing the fundamental principles of the market economy. Various economic theories have been developed over the last century, on the basis of which countries develop and implement their macroeconomic policies. In fact, the development of fiscal and monetary policies as the primary instruments of macroeconomic policy has evolved into a macroeconomic instrument that allows for effective, flexible, and prudent forecasting, which is required to accelerate the process of economic growth and stabilize the economy.

In particular, the Central Bank of Uzbekistan has followed the monetary targeting regime`s guiding principles for many years as it has developed its monetary policy, with a focus on limiting a sudden increase in the money supply in order to maintain the stability of the national currency. As operational and intermediate aims in this situation, reserve currency and changes in the money supply were utilised. Although this regime is formally categorized as monetary targeting, several international organizations and experts classify it as mixed since it gradually devalued the national currency by fixing the exchange rate to the dollar. However, under the influence of outside shocks, a dual-objective exchange rate strategy has been demonstrated to be ineffective. The objectives are, on the one hand, to enhance the gold currency reserves and, on the other hand, to preserve the soum`s exchange rate at a specific level. The balance of payments situation and the state of the foreign economy are not reflected in this exchange rate. As a result, this strategy hampered the ability to implement sound monetary policy and created issues on the domestic currency market. Additionally, using monetary and credit instruments in a passive manner introduced new challenges for the successful implementation of monetary targeting.

As a result, monetary policy needed to be revised and improved with modern tools. Beginning in 2017, the government directed the Central Bank to gradually reform monetary and credit

policy in accordance with the inflation targeting regime[1]. The first condition of the reforms is liberalization of the foreign exchange market. Beginning in September 2017, the official and unofficial exchange rates were unified, and the official rate was reduced by 48 percent, i.e. the unofficial exchange rate of 4210 soums for 1 US dollar was devalued and equalized to 8100 soums. By the end of 2019, the initial conditions for the transition to an inflation-targeting regime had been established, and beginning January 1, 2020, additional measures were put in place to gradually implement monetary policy in a completely new regime until 2023. Based on this, the Central Bank was tasked with lowering inflation to 10% by the end of 2021 and 5% by 2023, and to maintain this level as a constant goal of inflation targeting in subsequent periods.

Although the Central Bank was successful in meeting the short- and medium-term inflationary targets set forth before the monetary policy in the early years of the transition period, in recent years, as a result of the quick development of the financial markets in our nation, the introduction of new financial instruments, and the changes occurring in the global financial, economic, social, and geopolitical arenas. Events have made it harder for the monetary policy to achieve the goals it set for itself.

The geopolitical conflict that erupted in the world at the start of 2022, as well as the subsequent application of mutual sanctions between countries, hampered international trade and financial market operations. As a result, the population and business entities have increased their expectations of inflation and currency depreciation. Although the implemented restrictive monetary policy prevented the exchange rate from depreciating further, on the one hand, the current high demand in the economy caused the inflation rate to rise from 10.4 percent to 12.2 percent, on the other hand, the reduction in international trade due to sanctions, combined with other domestic conditions, reduced the GDP growth rate in 2022. It had dropped by 5.8% by the end of the third quarter and 5.4% by the end of the fourth quarter.

To understand and find appropriate course of actions to implement to restore economic growth fisrt of all it is important to investigate relationship between short and long term economic growth and monetary policy.

McCandless and Weber[2] examined data from 110 countries over a 30-year period using various definitions of money to study the relationship between long-term economic growth and monetary policy. McCandless and Weber provided evidence that monetary policy can affect the actual evolution of prices and production in a given country by studying the average rates of inflation, production growth, and growth rates of various monetary measures over a long period of time and for many countries. Two major conclusions emerge from their analysis.

[1] Decree of the President of the Republic of Uzbekistan dated 07.02.2017 No. PF-4947 "On the strategy of actions for the further development of the Republic of Uzbekistan"

[2] McCandless, G. T. Jr., and W. E. Weber. 1995. ‘‘Some Monetary Facts.’’ Federal Reserve Bank of Minneapolis Quarterly Review 19(3): 2–11

According to the first conclusion, the correlation between the inflation rate and the growth rate of the money supply is nearly equal to one and varies between 0.92 and 0.96 depending on the definition of the money supply used. This correlation generally supports one of the basic tenets of the quantity theory of money, namely that changes in the rate of money growth result in "an equal change in the rate of price inflation."[3].

Many other studies using smaller country samples and different time periods have found a strong positive relationship between inflation and money growth.[4].

The second general conclusion reached by McCandless and Weber is that there is no relationship between inflation or money supply growth and real output growth. This conclusion, however, was not as reliable as the one about the growth of the money supply and inflation.

Similarly, using data sets from nearly 50 countries and Geweke[5] for the United States, Cormendi and Maguire conclude that money supply growth has no long-run effect on real output growth.[6]

Several empirical studies, however, confirm that monetary policy is critical for economic growth. Specifically, Havi and Enu used an ordinary least squares (OLS) model to examine the relationship between economic growth and monetary policy in Ghana from 1980 to 2012, and discovered that money supply (monetary policy) had a positive effect on the Ghanaian economy.[7].

Kareem et. al using Ordinary least squares (OLS) model and correlation matrix models examined the impact of fiscal and monetary policy on economic growth in Nigeria between 1998 and 2008. They discovered that both narrow and broad monetary variables influence a country's economic growth (real GDP growth rate).[8]

Using a Bayesian approach to estimate a dynamic stochastic general equilibrium (DSGE) model, Moursi and El Mossallamy examined how Egypt's monetary policies affected inflation and growth. According to the analysis's findings, the impact of a bad monetary policy shock is greater on output than it is on inflation for the monthly time series data from 2002 to 2008 timeframe. This demonstrated that an expansionary monetary policy might spur economic growth without placing an undue burden on pricing.[9]

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[3] Lucas, R. E. Jr. 1972. ‘‘Expectations and the Neutrality of Money.’’ Journal of Economic Theory 4(2): 103–124.

[4] Lucas (1980b); Geweke (1986); and Rolnick and Weber (1994), Abel and Bernanke (1995, 242). Hall and Taylor (1997, 115)

[5] Geweke, J. 1986. ‘‘The Superneutrality of Money in the United States: An Interpretation of the Evidence.’’ Econometrica 54(1): 1–22.

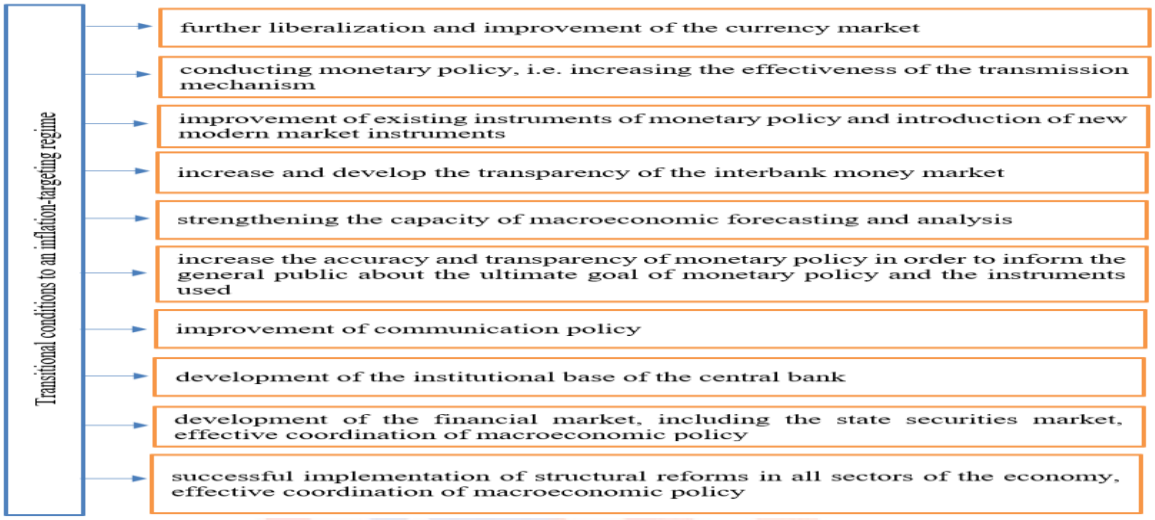
[6] Kormendi, R. C., and P. G. Meguire. 1984. ‘‘Cross-Regime Evidence of Macroeconomic Rationality.’’ Journal of Political Economy 92(5): 875–908.

[7] Havi, E. and Enu, P. (2014). The effect of fiscal policy and monetary policy on Ghana’s economic growth: which policy is more potent? *International Journal of Empirical Finance*, Vol 3, No.2, pp. 61-75.

[8] Kareem, R.O., Afolabi, A.J., Raheemand, K.A.and Bashir, N.O. (2013). Analysis of Fiscal and Monetary Policies on Economic Growth: Evidence from Nigerian Democracy. *Current Research Journal of Economic Theory,* Vol. 5, No. 1., (March), pp. 11-19.

[9] Moursi, T, A. and El Mossallamy, M. (2010). Monetary policy analysis with New Keynesian Models for Egypt. *Information and Decision Support Center (IDSC) of the Egyptian Cabinet Working paper*

Based on the above studies and international experience to develop effective monetary policy under inflation targeting regime its necessary first create preconditions. The following set of actions was chosen based on global experience to guarantee the macroeconomic circumstances required for the switch to an inflation targeting regime.



1- Fig. Necessary conditions for switching to the inflation targeting regime

As a result, starting on September 5, 2017, the Central Bank of the Republic of Uzbekistan stopped administratively setting the exchange rate. It also devalued the official exchange rate to 48%, or from the previously officially set 4.210 soums to 1 US dollar, and equalized the unofficial exchange rate, or 8.100 soums.

Although the MB performed better than anticipated in the first two years of the active phases of the transition to the inflation targeting regime (despite the effects of the SOVID-19 pandemic), 2022 ended the second quarter with a negative deviation of 3.5 percentage points from the intermediate goal of the established inflation target (intermediate target - 8.7%, in practice - 12.2%). The implementation of the intermediate aim of 7.5 percent set by the end of 2022 was brought into question by this circumstance (see Fig. 2).

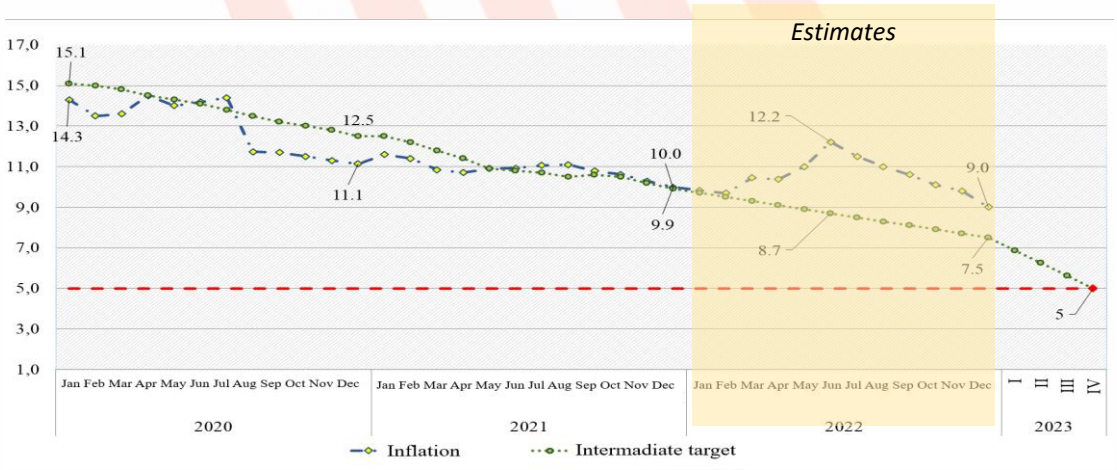


Fig. 2. Direction of inflation target and intermediate target in Uzbekistan

In summary, the geopolitical conflict between Russia and Ukraine and the sanctions that followed from the rise in energy prices, which increased both food and non-food prices, caused the production to fall in relation to aggregate demand in 2022, despite the easing of the coronovirus pandemic's restrictions.

Conclusions and policy recommendations

The following conclusions and recommendations were established in the context of the growth of the domestic financial market, accounting for the many consequences occurring both nationally and internationally, and enhancing monetary policy:

1. The study of theoretical research showed that, in addition to damaging price stability, excessive inflation rates also result in the depletion of savings, a decline in investment, and the outflow of capital to foreign assets or unproductive real estate. Consequently, the nation experiences social and political turmoil.

2. In recent years, it has become evident that the inflation targeting regime is the best course of action in light of the constantly expanding development of financial markets, as it includes contemporary instruments. Scientific practical studies demonstrate that the effectiveness of monetary policy in reducing inflationary pressure largely depends on the chosen regime.

3. For many years, the monetary policy in Uzbekistan has been conducted on the basis of the monetary targeting regime, which caused the Central Bank to be tasked with two tasks, such as regulating the exchange rate, as well as ensuring price stability. This led to a decrease in the transparency of monetary policy and its effectiveness in stabilizing prices.

5. The results of the analyses demonstrated that maintaining the central bank's independence is a prerequisite for implementing the inflation targeting regime and guaranteeing its successful implementation. It is suggested that Uzbekistan transition to a de jure and de facto free floating exchange rate as the next step in achieving this.

6. It is suggested to employ the process of selecting a model appropriate for the examined data set in order to improve the Central Bank's ability to anticipate inflation and evaluate the impact of the elements that generate it.

7. To improve the effectiveness of monetary credit policy through financial market development, it is proposed to diversify the stock market by broadening the range of participants and the composition of financial products ("green" bonds and other securities).

8. To improve the efficiency of the monetary policy transmission mechanism's credit channels, it is proposed to shift to the allocation of preferential and targeted loans at market rates within the framework of state socioeconomic development programs.

9. A proposal for implementing automatic fiscal stabilizer instruments was developed based on the synergistic effect of fiscal policy supporting monetary and credit policy during economic crises.

10. To enhance the communication channel of the monetary policy transmission mechanism, it is proposed to set the frequency of reporting by the Central Bank to Parliament at twice a year and to announce the results of the most recent meeting (Meeting Minutes) affecting the main rate no later than two weeks.

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