

FORMATION AND IMPLEMENTATION OF MONETARY POLICY IN THE CURRENT NEW ECONOMIC ENVIRONMENT

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Abstract

The paper discusses monetary policy, which is of key importance for ensuring economic growth, improving the economic situation, and strengthening the national currency. Particular attention have pay to the work to attract investments directed to the implementation of projects for the modernization, technical and technological renewal of industries. Since the investment policy plays an important role in ensuring economic stability during the crisis. According to the author, it is precisely the acceleration of the restructuring and modernization of the banking system based on the identification of additional resources for this purpose by reducing the tax burden on banks that will help the use of modern management methods and the formation of a healthy banking system.

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Introduction. Economic instability associated with rising prices for raw materials has spread to the real sector, the consequences of which threaten to be more dangerous, primarily for the economy with a high dependence on raw materials. The main factors that influenced the tightening of the credit policy of banks are also associated mainly with the deteriorating external environment. This may lead to uncertainty in the prospects for the development of the real estate market, a drop in the overall level of solvency of borrowers.

It is emphasized that sectors of the economy that were not previously classified as risky by banks, in the current situation, cause their close attention.

This primarily applies to trade and agriculture, and partly to the oil and gas and metallurgical industries, which emphasizes the systemic nature of the manifestation of the crisis and its spread in export-oriented industries.

Retail sector sees further decline in demand for mortgage lending and limited demand for consumer lending.

Under these conditions, an extremely important and responsible moment for the economy and the banking system comes for domestic banks. Economic growth is observed in the republic, associated mainly with intensive factors of economic development [3] and an improvement in the balance of payments. I would like to note that the developing confidence in monetary policy was also one of the foundations for achieving high rates of economic growth.

Analysis and results. The Central Bank of the Republic of Uzbekistan, in the process of conducting an effective monetary policy, links the goals of its activities with the economic policy of the state, the development of an economic growth trend with the obligatory provision of low inflation. In fact, this makes it possible to maintain confidence in the ongoing monetary policy. At the same time, it is difficult to expect confidence without strengthening the role of the banking system as a financial intermediary providing increasing financial resources in favour of effective investment projects, since the achieved economic growth will take on a long-term character.

The main goal of the monetary policy of the Central Bank of the Republic of Uzbekistan is to reduce inflation while maintaining GDP growth (see: Fig. 1).

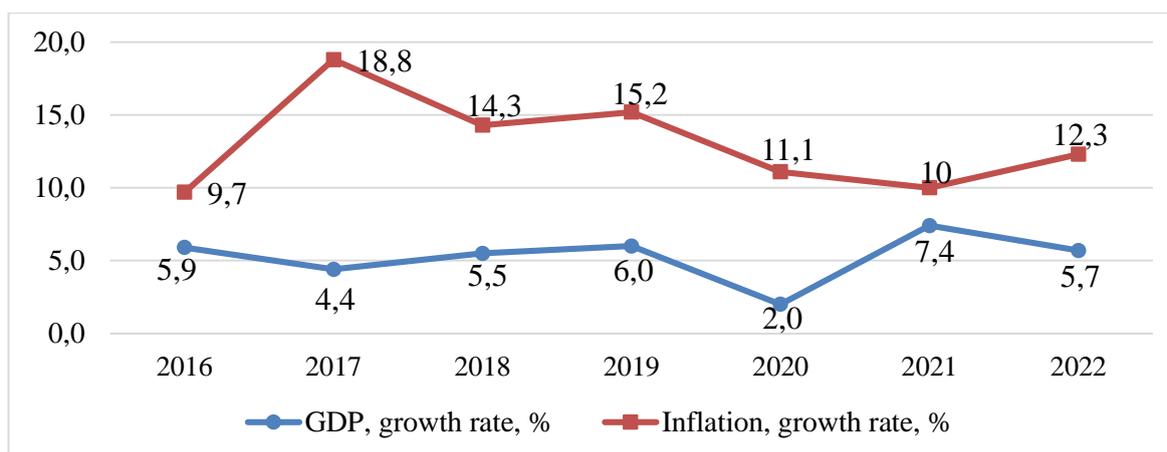


Fig. 1. Maintaining GDP growth while reducing inflation¹

According to Fig. 1, it can be concluded that inflation tended to decrease, however, due to the coronavirus pandemic, as well as the unstable development of the economy in recent years, inflation tended to increase to 12.3%, which immediately affected the decline GDP growth rate to 5.7%. Prudent monetary policy has led to a slowdown and stabilization of inflation.

It follows from this that the development of inflationary processes corresponds to the planned guidelines. The priority task of the current period is to consolidate and develop the trend of non-inflationary economic growth that has formed over the past year [4; 5].

In 2022, an increase in production was observed in all sectors of the economy. The profit of enterprises increased compared to the previous year, with a reduction in losses or a significant decrease in the share of unprofitable enterprises. Profitability remains high in almost all sectors of the economy. Thanks to the improvement in the financial situation of enterprises, their investment activity has intensified over the past year.

Apparently, while shaping monetary policy within the framework of the rule of law, we should not discount the fact that the state policy pursued in other countries, including monetary policy, has absorbed many years of experience and general democratic traditions. One of the main ones was the policy of attracting foreign capital to the country, which, on the one hand, was supposed to become a source of covering the budget deficit or ensuring a budget surplus, and on the other hand, to improve the state of the balance of payments. An important measure for the implementation of this policy was the modernization of the banking system of the Republic of Uzbekistan, which began in early 2000. In the current conditions, our state needs to assimilate everything positive that has been created in other industrialized countries. From this point of view, of greatest interest to us may be those elements of monetary policy that provide an increase in business activity in all areas of the economy, help identify directions in conflicting public, group and personal interests, help to take into account positive trends in

¹ Source: The Agency of Statistics under the President of the Republic of Uzbekistan. www.stat.uz.

the sources of economic growth.

The most serious attention deserves the work to attract investments directed to the implementation of projects for the modernization, technical and technological renewal of industries, structural transformations in the country's economy. For these purposes, in 2022, investments were attracted and disbursed from all sources of financing in the equivalent of 269.9 trillion soum, or with an increase against 2021 by 0.9%².

A significant role in achieving such a high level of gold and foreign exchange reserves, along with a favourable state of the trade balance, was played by the determination of the Ministry of Economy and Finance of the republic in the reasonable use of Central Bank loans to service external debt and finance budget expenditures this year.

The dynamics of the national exchange rate - the soum and gold and foreign exchange reserves testifies to the effectiveness of the Central Bank's foreign exchange policy, which not only contributes to the achievement of current goals, but also creates a reserve of strength in the monetary sphere for the future.

In the future, because of the positive development of fundamental factors, the trends that have developed in the domestic foreign exchange market should continue. This will be facilitated by the stabilization of oil prices at a sufficient level in the world markets, the traditional decrease in demand for foreign currency on the part of clients of commercial banks, as well as the effective policy of the Central Bank aimed at preventing speculative attacks on the national currency. The more active work of commercial banks with the real sector of the economy should also contribute to this.

Of course, the relative stability of the domestic political situation and the successful restructuring of the banking system had a favourable effect on the financial market, which manifested itself in a decrease in the profitability of its instruments. Economic liberalization measures also served to reduce the profitability of financial market participants. Under these conditions, the Central Bank lowered and raised the refinancing rate (see: Fig. 2).

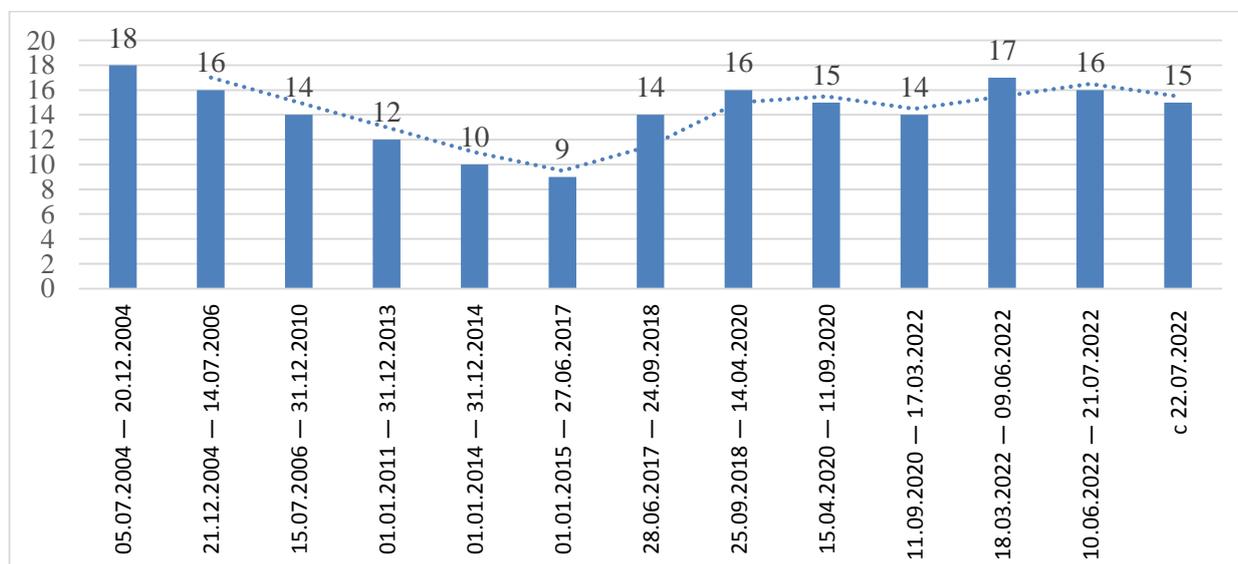


Fig. 2. Dynamics of the refinancing rate of the Central Bank of the Republic of Uzbekistan from 2004 to 2022³.

We emphasize that the decision to maintain the refinancing rate has an important informational effect for financial market participants, since it sets the trend in the cost of credit resources in the face of reduced inflation, an increase in gold and foreign exchange reserves, and an increase in industrial production.

² Source: The Agency of Statistics under the President of the Republic of Uzbekistan, www.stat.uz

³ Source: Central Bank of the Republic of Uzbekistan. www.cbu.uz

Given this, the Central Bank does not rule out a further reduction in the refinancing rate.

In addition to what has already been mentioned, at the current stage one of the main tasks of strengthening the banking system is to expand work with the real sector of the economy and the population.

The creation of favourable conditions for the recapitalization of banks, as well as the implementation of an active policy to improve solvency and improve the level of involvement in the process of cooperation in the interbank system at the international level, made it possible to create a foundation for the growth of the capital of the banking system. By the end of 2022, the share of banks with a total capital of more than 2 trillion soums increased from 75.9% to 81.4% in 2021 (see: Table 1). And in real terms, the capital of the banking system has not only been restored to the pre-crisis period, but also many times exceeds it.

Table 1 - Grouping of commercial banks by total and authorized capital⁴

The name of indicators	Total		of them:											
			up to 100 billion soums		from 100 to 300 billion soums		from 300 to 500 billion soums		from 500 billion to 1 trillion soums		from 1 to 2 trillion soums		from 2 trillion soums and higher	
	number of banks	sum (billion sum)	units	share in %	units	share in %	units	share in %	units	share in %	units	share in %	units	share in %
as of 01.04.2022														
Total capital	33	72 332	2	0,2%	9	2,1%	4	2,2%	2	2,1%	8	17,5%	8	75,9%
as of 01.04.2023														
Total capital	33	82 853	3	0,2%	5	1,0%	4	1,9%	5	5,1%	5	10,4%	11	81,4%

The growth of the total capital of the republic's banks occurred due to the growth of the authorized capital of banks through the issuance of additional shares with their subsequent placement among investors. In addition, such growth was provided at the expense of profit, i.e. the part that was aimed at increasing the authorized capital.

As of April 1, 2023, commercial banks invested 408.2 trillion rubles in loans in the real sector of the economy. soums, which is 20% more than last year. At the same time, the volume of deposits attracted to the banking system increased by more than 1.3 times compared to 2022 and amounted to 206.0 trillion soums as of April 1, 2023 (see.: fig. 3)⁵

⁴ Source: Central Bank of the Republic of Uzbekistan. www.cbu.uz

⁵ Source: Central Bank of the Republic of Uzbekistan. www.cbu.uz

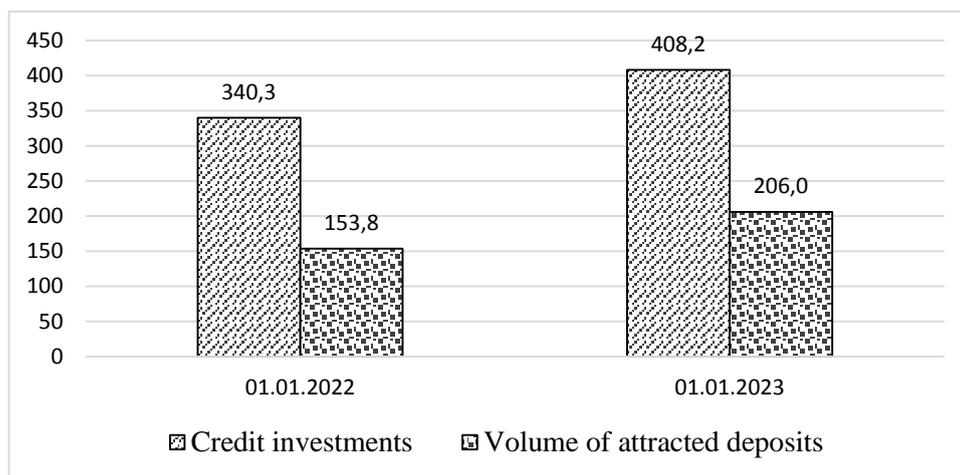


Fig. 3. Loans and deposits attracted to the banking sector, trillion soums⁶

Thus, the results of the activities of commercial banks showed a strengthening of the positive trends emerging in 2023 - an increase in the scale of banking activities and an improvement in the financial condition of banks.

An important result of the first stage of restructuring is the reduction in the number of troubled commercial banks. Their share in total banking assets decreased.

The trend towards the expansion of the presence of foreign capital in the banking sector can be assessed as very positive. The volume of foreign investments in the authorized capital of banks increased.

In the emerging new economic conditions, problems in the field of the banking system and ways to solve them are paramount. The success achieved in priority areas of monetary policy and in a number of key indicators does not yet mean that the consequences of the global financial and economic crisis have been completely overcome. Despite the fact that the measures taken at the first stage to reform the banking system have brought positive results, they need to be continued further.

In the emerging new economic conditions, the presence of problematic credit situations in the banking system, in many countries with economies in transition, is evidenced by the share of bad loans in the bank loan portfolio, although they are decreasing. The total assets and loans of the banking system of the Republic of Uzbekistan in real terms not only reached, but also exceeded the pre-crisis level (see: Fig. 4).

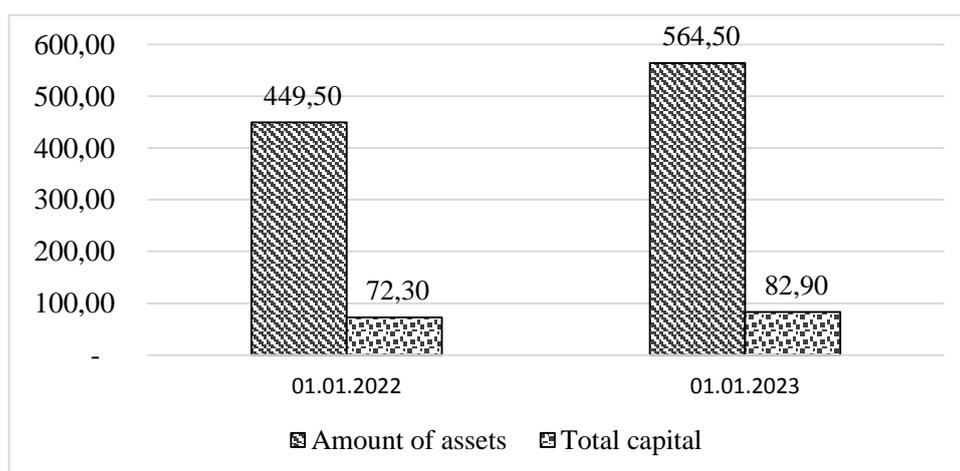


Fig. 4. Total assets and capital of commercial banks in Uzbekistan, trillion soums⁷

⁶ Source: Central Bank of the Republic of Uzbekistan. www.cbu.uz

⁷ Source: Central Bank of the Republic of Uzbekistan. www.cbu.uz

Therefore, at the stage of modernization of the banking system, there is a medium-term task for the banking sector to enter the trajectory of stable growth in real volumes of operations and the capital base, to minimize the impact of problem loans on the financial condition of banks as a whole, as well as an economically justified expansion of lending to the non-financial sector of the economy.

Given the importance of the problem of recapitalization of commercial banks, in addition to the efforts of banks to increase capital, a serious review of the system of taxation of banking activities is necessary. In particular, it is necessary to expand the system of tax incentives for income (profit) received from banking services, with the subsequent introduction of the amount of tax incentives into the authorized capital [6]. This will significantly expand the ability of banks to increase capital. It would also be advisable to consider the possibility of establishing the same profit tax rate for banks as for manufacturing enterprises, reducing tax rates in relation to income received from the placement of securities, as well as excluding from the taxable base income tax, the amounts of reserves formed by banks for possible losses, including loans. It is also necessary to resolve the issue of the possibility of including the costs of creating reserves in the cost of banking services. Only in this case will it be possible to increase the amount of lending to the real economy.

Significant work has been done in Uzbekistan to strengthen the tools of banking supervision and bring it into line with international standards, as one of the most important areas of activity in the framework of the restructuring of the banking system [1; 2]. Despite this, the task must be at the center of our attention in order to ensure the effectiveness of the restructuring measures. It must become pivotal. At the same time, the Central Bank should proceed from the fact that the system of banking supervision should be the same for all banks, regardless of the size and specialization of activities. Improving supervision should include a number of areas:

Firstly, this is the improvement of the requirements for the licensing of banking activities. Particular attention should be paid to the analysis of the financial position of the founders (participants) of banks and the study of the possible impact of the interdependence of the founders (participants) and their corporate groups on the activities of banks.

Secondly, it is the continuation of work on the practical implementation of supervision methods on a consolidated basis. Although the documents of the Central Bank, the regulatory framework in this consolidated supervision needs to be finalized, taking into account the practical results of its application to the full extent of the possibilities of consolidated reporting. To do this, it is necessary to give the Central Bank the right to require the inclusion in the reporting data on banking groups of information not only about banks, but also about non-banking organizations.

Thirdly, it is the improvement of the methodology for analyzing the state of the banking system. In practice, we are talking about the need to expand the content of analytical work, supplementing the assessment of traditional credit and liquidity risks with an assessment of market and operational risks. The issue of developing methods for analysing currency, interest rate, stock risks, as well as aggregating all risks is also relevant. An important aspect of this task should be the development of an "early warning" system of possible problems in the activities of banks, including the analysis of reporting and "spot" inspections.

Fourth, it is the improvement of the procedure for creating reserves for possible losses, for which it is necessary to expand the range of instruments for which banks must form reserves for possible losses. Such preparation work requires an appropriate regulatory document of the Central Bank.

Fifth, it is the development of interbank risk management. The Central Bank should proceed from the fact that improving the quality of banking risk management is one of the key elements in strengthening the financial stability of banks, increasing confidence in banks on the part of customers, creditors and depositors.

In the emerging new conditions for the development of the most promising direction of banking operations, i.e. lending to the real sector of the economy - the management faces a number of significant and insurmountable restrictions. A significant factor hindering the lending activity of banks is the high risks of lending to enterprises. Despite the reduction in the general risks of lending to the real sector due to the improvement of the macroeconomic situation, the conditions for marketing products and the growth of profits, institutional elements of risks remain high, first of all, the system of taxation of production and financial activities, which requires an increase in its efficiency; the narrowness of the legislative framework in the field of protecting the rights of creditors, the cumbersomeness of the financial statements of enterprises, in general, affects the intensity of the restructuring of enterprises in the real sector of the economy.

Undoubtedly, the unjustified formation of lending to the real sector of the economy in volumes that are inadequate to existing banking risks can lead to a decrease in the stability of the banking system and be a significant obstacle to solving the main task of restructuring, the task of effective interaction with the non-financial sector. Work to reduce investment risks is very important. The list of financial instruments that could be used for this purpose is well known: the provision of syndicated loans that allow the distribution of risks, insurance of investment and credit risks. With regard to syndicated lending, it should be noted that with its help, borrowers receive very large amounts, which, as a rule, no bank alone risks giving large amounts of credit. Banks should take the initiative and encourage the formation of so-called institutional investors, which is especially important in the face of declining microeconomic risks.

Another constraint on the expansion of lending to the real sector of the economy is the lack of long-term resources.

Conclusion. Summarizing the above, it should be noted that one of the most important issues in the activities of banks is the issue of ensuring confidence in the banking system on the part of customers, creditors and depositors, measures to increase the degree of transparency of banks. In this regard, the Central Bank should introduce a number of clarifications to the laws. In particular, it is planned to supplement the current legislation with the requirements for the quarterly publication in the press of the balance sheets and financial results of banks, as well as such key financial indicators as capital adequacy and the amount of reserves to cover doubtful assets.

It is necessary to tighten the control of the Central Bank over the reflection in the reports submitted as part of the implementation of documentary supervision of the real state of affairs in banks. This will require systematic inspections and the application of appropriate sanctions to violators, control over the elimination of violations (inconsistencies) identified by banks. In this regard, it is necessary to amend the current legislation, which provides for the Central Bank to be entitled to reevaluate the assets of banks.

In our opinion, in the context of the restructuring of the banking system, in a still developing economy, a slight increase in the level of the budget deficit will have a negative impact on the situation in the banking service.

Therefore, monetary policy, in the emerging new economic situation, should provide for a number of important areas, should highlight priority measures, in particular, accelerating the restructuring and modernization of the banking system on the basis of identifying additional resources for this purpose by reducing the tax burden on banks, primarily in turn, by establishing an income tax rate in the amount adopted for enterprises, reducing the tax base and attributing to bank expenses the costs of creating a number of reserves, establishing tax incentives, etc., stimulating the use of profits to increase capital, etc.;

- creating conditions for expanding the participation of foreign capital in the banking business, which will help the use of modern management methods and create conditions for the accelerated transition of commercial banks to international accounting and financial reporting standards;

- take effective measures, including a temporary refusal of the Central Bank to further increase reserves

for other possible losses.

All this will provide an opportunity to form a healthy banking system, both at the domestic and international levels.

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