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INFLATION TARGETING REGIME IN MONETARY REFORMS

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Abstract

Many countries use the inflation targeting regime as an effective method of conducting monetary policy in the market economy. In accordance with the Decree of the President of the Republic of Uzbekistan “On improving monetary policy through a phased transition to an inflation targeting regime,” a number of measures were implemented. As a result, the achievements and shortcomings achieved, as well as some opinions and recommendations for their elimination, were presented.

Keywords. Inflation, inflation targeting, Republic of Uzbekistan, Central Bank, monetary policy, financial market, exchange rate, price.

Introduction

An important factor in ensuring the effectiveness of economic reforms aimed at improving the living standards of the population and creating conditions for sustainable economic growth in our country is the implementation of measures to further reduce the level of inflation.

In accordance with the Decree of the President of the Republic of Uzbekistan No. PF-5877 dated November 18, 2019 “On improving monetary policy through a phased transition to an inflation targeting regime,” a number of legal documents have been developed and adopted. In accordance with this, the concept, action plan, roadmap, and others have come into force.

Inflation targeting is an effective method of conducting monetary policy in a market economy. It is emphasized that the active participation of the central bank in the monetary market, as well as regular analysis of economic development and wide coverage of government policy plans, ensure the achievement of quantitative inflation targets.

The inflation targeting (IT) regime came to us as a foreign experience. On the recommendation of the International Monetary Fund, initial measures to transition to the IT regime were implemented in practice and showed the following results:

- The Central Bank of the Republic of Uzbekistan (CBU) adopted a new approach in September 2017, according to which the objective of monetary policy was changed to achieving price stability;
- In January 2020, the RBI set a target to transition to the IRR and reduce inflation to 10% by the end of 2021 and to 5% by the end of 2023. However, in practice it amounted to more than 9%;
- Starting from 2017, the transition from dependence on the previous exchange rate to an active monetary policy, in which at first the liquidity of banks became the operational target indicator of the Central Bank of Ukraine, and later they were replaced by the main rate and the money market interest rate;
- Short-term forecasting models for inflation and other macroeconomic indicators have been developed. The RBI has introduced the FPAS[1] model to develop analytical capacity;
- Since 2018, the Central Bank of Ukraine has been publishing a quarterly review of the monetary policy, and started publishing a statistical bulletin every month;
- At the end of 2019, the (newly revised) laws on currency regulation, payment system, and banking activities were approved. It was decided that preferential loans cannot be granted at a rate lower than the Central Bank's key rate;
- After a temporary spike in inflation following the 50 percent devaluation in September 2017, inflation has been on a downward trend as a result of the gradual tightening of monetary conditions. However, inflation is still relatively high;
- The exchange rate has generally moved in line with the main indicators. However, given the relatively low volume of transactions in the market and the presence of large transactions by the government and state-owned enterprises, the RBI is faced with the need to carry out daily interventions to prevent sharp fluctuations;
- The underdevelopment of the financial market, the high level of dollarization, government lending programs, and the high share of state-owned banks and state-owned enterprises in the economy are the main factors limiting the transmission of monetary policy. Although the interbank money market has developed rapidly since the beginning of 2020, some signs of market

[1] FPAS – "Forecasting and Policy Analysis System" is actively used by central banks that have switched to IT today to conduct medium-term macroeconomic forecasting.

segmentation still exist, with some banks consistently participating in the market as either borrowers or lenders.

➢ High dollarization also hinders the transmission of monetary policy. High dollarization reduces the base of loans and deposits that can be influenced by monetary policy. The higher the level of dollarization, the lower the transmission of monetary policy;

➢ The dominance of state-owned banks and government lending programs also limit the transmission of monetary policy. 11 out of 31 banks in the country are state-owned banks, which account for about 82 percent of the banking sector's assets.

The above information is based on studies and analyses conducted by foreign experts. Taking into account the monitoring of inflation targeting processes and the achievements and shortcomings, we consider the following recommendations to be appropriate:

✓ By further improving the independence, transparency and management of the Central Bank, it is possible to increase the effectiveness of the activity. Confidence building is important for the effectiveness of monetary policy;

✓ It is necessary to strengthen cooperation with the government on policy issues that affect inflation. Preferential lending programs, regulation of utility prices, and public sector wage policy are important policies that affect the transmission of monetary policy and inflation;

✓ By increasing the volatility of the exchange rate, its impact on inflation expectations can be reduced. In cases of moderate and unpredictable exchange rate fluctuations, our economy pays little attention to exchange rate dynamics, which, in turn, reduces the correlation between the exchange rate and inflation. This, in turn, requires the development of the foreign exchange market.

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