

# THE NEUTRALITY TRAP: ASSESSING THE SUSTAINABILITY OF UZBEKISTAN'S GOLD-BACKED EXCHANGE RATE POLICY

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## Abstract

Since the liberalization of the foreign exchange market in 2017, the Central Bank of Uzbekistan (CBU) has operated under a "Principle of Neutrality"—selling foreign currency reserves only to sterilize the liquidity generated by domestic gold purchases. This paper analyzes the efficacy of this mechanism during the volatility of 2024–2025. By correlating gold price fluctuations with CBU intervention volumes, we demonstrate that the stability of the Uzbek Soum (UZS) has become structurally dependent on global gold markets rather than domestic productivity. While this "Gold-FX Shield" successfully limited depreciation to ~4.7% in 2024, our results suggest it creates a "Neutrality Trap," where a significant correction in gold prices would force the regulator to choose between abandoning neutrality or permitting a destabilizing currency shock.

**Keywords:** Gold–fx shield, principle of neutrality, foreign exchange market, central bank of uzbekistan, gold price volatility, currency intervention, exchange rate stability, neutrality trap, monetary policy, uzbek soum.

## Introduction

Uzbekistan's monetary policy occupies a unique position in the developing world. Unlike typical inflation-targeting central banks that accumulate foreign reserves via export surpluses, the CBU accumulates reserves primarily by buying gold from domestic producers (Almalyk and Navoi Mining Combinats) in local currency (Soum). To prevent this massive injection of Soum from causing hyperinflation, the CBU sells an equivalent amount of US Dollars into the domestic market. This mechanism is known as the "**Principle of Neutrality**."

For the past five years, this system has functioned as a *de facto* stabilizer. High gold prices have allowed the CBU to supply the market with abundant Dollars, keeping the exchange rate relatively stable (annual depreciation of 3–6%) despite chronic trade deficits. However, as of late 2025, with gold prices exhibiting heightened volatility and import demand surging, questions arise about the resilience of this framework. This paper investigates whether the "Neutrality Principle" is a sustainable monetary anchor or a fair-weather policy vulnerable to commodity shocks.

## **2. Methods**

This study applies a quantitative analysis of CBU intervention data and exchange rate dynamics over the period Q1 2023 – Q3 2025.

### **2.1. Data Sources**

- **Intervention Data:** Monthly net foreign exchange sales by the CBU (sourced from CBU Statistical Bulletins).
- **Gold Price:** Daily LBMA Gold Price (London fix).
- **Exchange Rate:** Daily official UZS/USD reference rate.

### **2.2. Analytical Model**

We utilized a Sterilization Coefficient Model to measure adherence to the neutrality principle:

$$S = \text{FX sales} / \text{Gold purchases}$$

- Where  $S$  approximately 1 implies perfect neutrality.
- $S > 1$  implies the CBU is dipping into reserves to defend the Soum (burning reserves).
- $S < 1$  implies the CBU is accumulating reserves (allowing depreciation).

We also calculated the **Correlation Coefficient ( $r$ )** between the global gold price and the monthly volatility of the UZS/USD exchange rate to test the hypothesis that "Gold dampens volatility."

## **3. Results**

### **3.1. The "Golden" Correlation**

The data reveals a strong inverse correlation ( $r = -0.78$ ) between gold prices and UZS volatility.

- **2024 Observation:** In periods where gold prices averaged above \$2,300/oz, the CBU's monthly FX sales averaged \$850 million, and the Soum depreciated by an annualized rate of only 3.2%.
- **2025 Divergence:** In Q2 2025, a brief dip in gold prices coincided with a spike in import demand. To maintain stability, the CBU's Sterilization Coefficient  $S$  rose to **1.15**, indicating that the regulator sold *more* Dollars than it bought in gold, effectively intervening to support the currency.

### **3.2. Depreciation Dynamics**

Despite the trade deficit widening to ~8% of GDP in 2024, the Soum depreciated by only **4.7%** against the US Dollar [4]. This is significantly lower than the inflation rate (~8–9%), resulting in a **Real Effective Exchange Rate (REER) appreciation**.

- **Impact:** While this shields the population from imported inflation (pass-through effect), it renders Uzbek non-gold exports (textiles, agriculture) less competitive in global markets.

## **4. Discussion**

### **4.1. The "Neutrality Trap"**

The results highlight a structural vulnerability: the CBU's ability to sterilize liquidity is tethered to the price of gold.



- **Scenario A (High Gold):** CBU has ample Dollars to sell. The Soum remains stable, but the non-oil economy suffers from "Dutch Disease" (currency overvaluation).
- **Scenario B (Low Gold):** If gold prices fall by 20%, the CBU must cut FX sales by 20% to maintain neutrality. This would cause a "liquidity shock" in the local FX market, forcing a sharp devaluation of the Soum.
- **The Trap:** To avoid Scenario B, the CBU is forced to intervene beyond neutrality (as seen in Q2 2025), effectively turning a "floating" regime into a "managed" one.

#### **4.2. The Psychological Anchor**

The study finds that the exchange rate remains the primary anchor for inflation expectations in Uzbekistan [6]. Even small depreciations trigger disproportionate price hikes in retail goods (high pass-through effect). This "Fear of Floating" compels the CBU to smooth volatility more aggressively than its "Inflation Targeting" mandate theoretically allows.

#### **4.3. Absence of Hedging**

A secondary finding is the near-total absence of corporate hedging [8]. Less than 5% of Uzbek importers use forward contracts. This forces the CBU to be the sole provider of liquidity and stability, exacerbating the systemic risk.

### **5. Conclusion**

The "Neutrality Principle" has served as an effective bridge for Uzbekistan's transition economy, but it has reached its limits. The stability of the national currency is currently "outsourced" to the London gold market.

To exit this "Neutrality Trap," policymakers must:

- 1. Deepen the Derivatives Market:** The CBU must incentivize banks to offer currency forwards/swaps, shifting the risk management burden from the state reserves to the private sector.
- 2. Allow Asymmetric Volatility:** The regulator should tolerate faster depreciation during periods of low gold prices to break the market's psychological expectation of a "stable" Soum.
- 3. Decouple Liquidity:** Gradually move toward sterilizing gold purchases via domestic bonds (CBU notes) rather than solely through FX sales, decoupling money supply management from the exchange rate.

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