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ENHANCING THE EFFECTIVENESS OF MONETARY POLICY TRANSMISSION IN UZBEKISTAN

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Abstract: This article analyzes the mechanisms for enhancing the transmission of monetary policy in Uzbekistan. It examines the Central Bank's reforms—particularly interest rate policy, development of the interbank market, and the adoption of inflation targeting - as critical tools to improve the effectiveness of monetary policy on economic dynamics. Drawing on statistical data, the paper explores existing challenges and proposes strategic directions to strengthen monetary instruments and foster sustainable economic growth.

Keywords: Monetary policy, transmission mechanism, inflation targeting, Central Bank, interest rate, economic growth, financial stability.

Аннотация: В статье рассматриваются направления повышения эффективности трансмиссионного механизма денежно-кредитной политики в Узбекистане. Особое внимание уделено мерам, предпринимаемым Центральным банком, включая переход к режиму инфляционного таргетирования, развитие межбанковского денежного рынка и совершенствование процентной политики. На основе анализа макроэкономических и статистических данных обоснованы предложения по укреплению роли процентного канала, повышению прозрачности и предсказуемости монетарной политики, а также по созданию благоприятных условий для устойчивого экономического роста.

Ключевые слова:денежно-кредитная политика, трансмиссионный механизм, инфляционное таргетирование, Центральный банк, процентные ставки, экономический рост, финансовая стабильность, межбанковский рынок.

Introduction. In recent years, Uzbekistan has embarked on a comprehensive transformation of its monetary policy framework, aiming to improve macroeconomic stability and foster sustainable economic growth. Central to this reform process is the enhancement of monetary policy transmission mechanisms, which play a pivotal role in translating central bank decisions into real-sector outcomes. The move towards a more market-oriented and transparent monetary policy—especially the gradual adoption of inflation targeting—has marked a significant shift in Uzbekistan's economic governance. However, the effectiveness of monetary policy transmission remains a complex challenge, influenced by various structural, institutional, and financial market factors. In particular, underdeveloped interbank markets, limited financial

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deepening, and asymmetric information continue to hinder the efficient pass-through of policy signals to interest rates, credit conditions, and ultimately investment and consumption.

Main part. In its pursuit of a more effective monetary policy framework, the Central Bank of Uzbekistan (CBU) has initiated a set of deep structural reforms aimed at strengthening operational mechanisms and providing clear, consistent policy signals to market participants. A central objective of these efforts is to enhance the transmission of monetary impulses to the real economy by improving the responsiveness of key financial markets and institutions. One of the core strategies involves the development of the interbank money market and the establishment of a robust REPO (repurchase agreement) infrastructure. Strengthening these platforms is essential for reinforcing the interest rate channel of monetary transmission, as it allows commercial banks to manage liquidity more efficiently and actively participate in the formation of short-term market interest rates. As banks become more responsive to central bank signals, the speed and precision with which monetary policy affects broader macroeconomic variables—such as investment, inflation, and output—will significantly improve.

Another important challenge being addressed is the misalignment between the yield of central bank securities and the upper bound of the interest rate corridor. At present, yields on government and central bank securities tend to cluster near the upper limit of the policy corridor, which risks distorting the clarity and predictability of monetary signals. To mitigate this, the CBU plans to realign securities yields with market-based mechanisms by gradually increasing the share of deposit auctions and phasing out rigid interest rate caps. The underlying objective is to ensure that the pricing of monetary instruments is guided by market expectations rather than administrative controls, thereby enhancing transparency and policy credibility. Furthermore, the Central Bank is moving away from acting as a price-setter in its securities market operations, instead positioning itself as a price-taker within a market-determined framework. A critical step in this direction was taken in March 2024, when the interest rate ceiling on central bank bonds was extended to the upper boundary of the policy corridor. Future plans include the complete removal of such limits, enabling a flexible pricing system driven by the natural interplay of demand and supply. This shift is expected to strengthen competition within financial markets and improve the integration of monetary policy with broader market dynamics. An additional reform involves extending the operational hours of overnight liquidity facilities. Currently, overnight transactions are executed between 10:00 and 16:00; however, with most interbank settlements occurring until 17:00, this window may limit the flexibility of commercial banks to respond to liquidity needs in real-time. By extending the operational window, the Central Bank aims to enhance liquidity management, improve the smooth functioning of payment systems, and reduce end-of-day volatility in money markets. Collectively, these initiatives reflect a coherent effort to modernize Uzbekistan's monetary architecture. By advancing toward a more flexible, market-based, and analytically grounded framework, the Central Bank is not only strengthening monetary policy transmission but also contributing to long-term macroeconomic stability and investor confidence. In response to the structural timing gap between transaction windows and interbank settlement deadlines, the Central Bank of Uzbekistan (CBU) is considering the extension of the overnight operations window by an additional 30 minutes beyond the current 16:00 closing time. This expansion would allow commercial banks to manage end-of-day liquidity with greater flexibility, thereby enhancing systemic financial stability. By providing extended access to central bank facilities, the policy aims to mitigate liquidity bottlenecks during critical operational hours. Currently, interbank money market transactions are primarily conducted during official banking hours,

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usually up until the conclusion of the payment day. However, allowing such operations to continue for an additional 15 minutes after the formal settlement window closes is expected to yield significant benefits. In particular, commercial banks would gain an opportunity to redistribute short-term liquidity among themselves before resorting to overnight lending from the Central Bank. This sequence reduces excessive reliance on central bank interventions and fosters a more market-oriented liquidity allocation mechanism. Another crucial reform is the transformation of overnight operations into a "true overnight" structure. Presently, such transactions are carried out based on mutual agreements between banks, often settled flexibly within a 24-hour window. This practice differs from the more standardized mechanisms used by the Central Bank, leading to inconsistencies in how short-term liquidity is priced and managed. Institutionalizing real overnight operations—where transactions are repaid at the beginning of the next working day—will enhance predictability, standardization, and alignment with the Central Bank's monetary stance. Looking ahead, the introduction of an intraday credit facility is also under consideration. This facility would allow banks to access interest-free, collateralized credit during the day, specifically designed to bridge temporary liquidity shortfalls and ensure the uninterrupted functioning of the payment system. By addressing liquidity mismatches within the day, this tool would reduce operational risk and bolster trust in financial market infrastructure. Furthermore, it would facilitate a smoother repayment of overnight deposits at the beginning of the next business day, thereby reducing liquidity management pressures. In addition to these operational enhancements, the CBU is also evaluating the implementation of a new instrument known as "fine-tuning operations." Although not yet applied in practice, these short-term open market operations would serve as an essential tool for managing unexpected liquidity fluctuations. Their use would enable the Central Bank to respond promptly to deviations from targeted monetary conditions, improving the precision and flexibility of policy interventions. Taken together, these reforms represent a significant shift toward a more efficient, market-responsive, and transparent monetary policy framework in Uzbekistan. By aligning operational practices with international standards and focusing on the robustness of transmission channels, the Central Bank aims to create a more resilient financial system—one capable of withstanding shocks while supporting stable and sustainable economic growth.

Uzbekistan's monetary policy has undergone a substantial transformation over the past decade, transitioning from administratively controlled interest rate frameworks to a market-based inflation-targeting regime. This shift has been instrumental in reinforcing the transmission of monetary impulses to the broader economy, though several structural and operational bottlenecks persist. One of the most significant achievements has been the strengthening of the interest rate channel, evidenced by the increased responsiveness of inflation and investment dynamics to changes in the policy rate. Since 2022, tighter monetary policy measures, including adjustments to the refinancing rate and liquidity operations, have successfully helped in curbing inflation, which had previously been driven by fiscal expansion, rising import prices, and currency depreciation. At the operational level, the Central Bank of Uzbekistan (CBU) has taken meaningful steps to align its policy instruments with market-based benchmarks. The development of the interbank REPO market and reforms aimed at reducing direct administrative control over interest rates have improved the transmission efficiency. The move to gradually abolish the upper bounds of the interest rate corridor for government securities is another key reform that ensures more transparent and predictable monetary signals to market participants. However, certain frictions remain, notably in the weak development of secondary financial markets and limited monetary depth. For instance, the overnight operations

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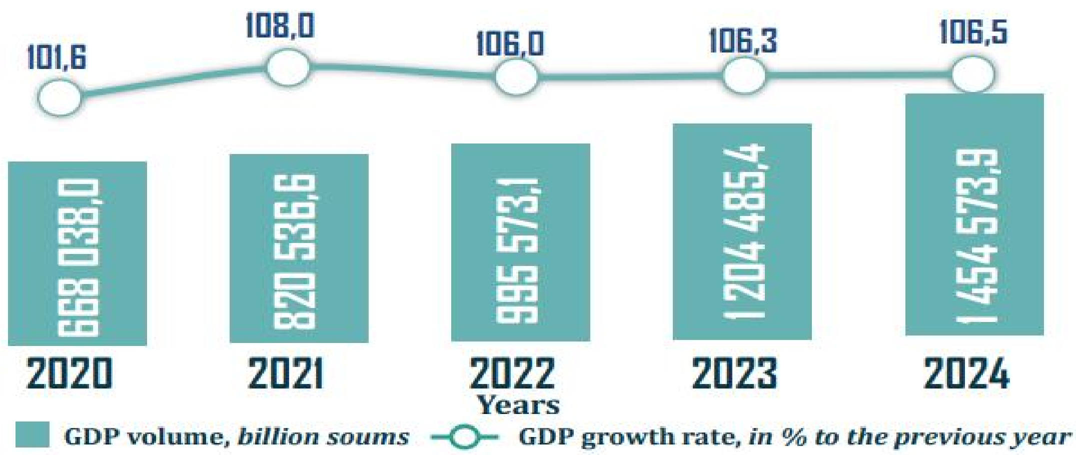
and interbank transactions are often concentrated within narrow time windows, limiting banks' flexibility in managing short-term liquidity. The proposal to extend operating hours and introduce “real overnight” instruments is likely to address these constraints and enhance the transmission through the liquidity channel. Moreover, expectations management—crucial under inflation targeting—is still in its formative stage. While inflation forecasts have become more transparent, anchoring public and market expectations remains challenging due to exchange rate volatility and external shocks. The Central Bank’s consistent communication strategy, paired with analytical forecasting tools, will be critical in shaping rational inflation expectations and improving the credibility of monetary policy. In addition, future enhancements such as introducing intraday credit facilities and institutionalizing fine-tuning operations could provide the flexibility needed to deal with unexpected liquidity imbalances. These tools, commonly used by advanced central banks, will allow Uzbekistan to move closer to an agile and responsive monetary system capable of buffering both internal and external shocks.



1-picture. Dynamics of Gross Domestic Product (GDP) of the Republic of Uzbekistan[1].

According to the preliminary estimate by the Statistics Agency of Uzbekistan, the country's Gross Domestic Product (GDP) in current prices reached 1,454,573.9 billion soums in 2024, reflecting a real growth rate of 6.5% compared to 2023. Additionally, the GDP deflator index stood at 113.3%, indicating moderate inflationary pressure in the broader economy. These figures highlight a period of robust economic expansion, which coincides with the ongoing modernization of Uzbekistan’s monetary policy framework.The observed economic growth suggests that the monetary transmission mechanism—through which interest rate changes impact aggregate demand—has become more responsive. In particular, the real GDP growth, coupled with a relatively contained inflation rate, signals that the Central Bank’s use of interest rate instruments, repo operations, and open market interventions is increasingly aligned with macroeconomic objectives. Moreover, the GDP deflator, which measures the price level of all domestically produced goods and services, points to a sustained but manageable inflation dynamic—offering further credibility to the inflation-targeting approach gradually being adopted by the Central Bank. This data-driven progress underscores the importance of strengthening financial market infrastructure—especially interbank liquidity tools and benchmark interest rates—to enhance the predictability and efficiency of monetary signals. As

[1] Independently compiled by the researcher based on statistical data.

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the GDP expands, a more sophisticated and transparent monetary transmission system becomes essential to ensure that policy rate adjustments effectively influence lending, investment decisions, and inflation expectations. Therefore, improving communication strategies, increasing the role of market-based interest rates, and adopting a more flexible operational framework remain critical to reinforcing the link between monetary policy actions and real economic outcomes in Uzbekistan.

Conclusion. In summary, although Uzbekistan has made significant strides in strengthening its monetary policy transmission mechanisms, the long-term effectiveness of these reforms will largely depend on the Central Bank's ability to further develop financial markets, uphold consistent policy implementation, and solidify trust in its inflation-targeting framework. Achieving these goals will require a sustained commitment to institutional modernization, the expansion of market-based instruments, and the integration of real-time economic data into policy formulation. By prioritizing these areas, Uzbekistan can enhance the responsiveness of its monetary system and support a more stable and inclusive path toward sustainable economic growth.

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