
DIRECTIONS OF ENSURING NATIONAL CURRENCY STABILITY AND THE MAIN ASPECTS OF THE DEVELOPMENT OF FOREIGN EXCHANGE RATE IN UZBEKISTAN

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ABSTRACT:

A national currency is a legal tender issued by a country's central bank or monetary authority. It is typically the predominant medium of exchange for purchasing goods and services. In Uzbekistan, the Uzbek soum (UZS) is the primary form of currency, backed by the full faith and credit of the government and the National Reserve. In Uzbekistan the Central Bank has the right to oblige commercial banks to keep the minimum mandatory reserves in special reserves. Stabilization of such reserves is determined by the type of bank's liabilities, deposit and lifetime. This mechanism is mainly used to coordinate the volume of liquid assets of commercial banks.

Keywords: currency, money system, assets, commercial banks, Central Bank, loan, money supply, price fluctuations, refinancing, revaluation, devaluation, denomination.

INTRODUCTION:

As every country has its own currency the independence of Uzbekistan also required its independent monetary system. The first stage of the establishment of the independent monetary system was the issue of "UZS-coupons" from November 15, 1993. The second stage of the formation of money system in

Uzbekistan was the circulation of the national currency "UZS" since July, 1994, which was the great importance in the history of Uzbekistan.

In every country monetary treatment is regulated by certain rules. In the market economy it is monitored by definite procedures.

The Central Bank of the Republic of Uzbekistan implements the following procedures to regulate monetary treatment:

1. Establishment of the mandatory reserve rate.
2. Participation of the commercial banks in the open market.
3. Determination of the Refinancing Rate for Centralized Loans.

According to the Law "On the Central Bank of the Republic of Uzbekistan", the Central Bank has the right to oblige commercial banks to keep the minimum mandatory reserves in special reserves.

Stabilization of such reserves is determined by the type of bank's liabilities, deposit and lifetime. This mechanism is mainly used to coordinate the volume of liquid assets of commercial banks.

By this the Central Bank affects the lending ability of commercial banks. The loan, in its turn, leads to an increase in the money supply, price fluctuations. For this reason, the mandatory norm does not change frequently, as it can lead to fluctuations in the circulation

of money and, consequently, economic instability.

The Central Bank defines the refinancing rate for commercial banks. This rate serves as a basis for determining the value of a loan issued by commercial banks. Refinancing policy does not affect commercial banks to fund from other sources. The Central Bank will establish a reasonable refinancing rate and coordinate the liquidity of commercial banks.

The circulation of money can be stabilized by the following ways:

Revaluation, devaluation, denomination. Depending on the country's economic development, the state of economy, the inflation rate, the state policy the government may conduct monetary reform, revaluation and denomination.

In the case of strong depreciation of money, monetary system can be stabilized only through monetary reform.

Monetary reform, that is, multiplication means a strongly depreciated currency which canceled and replaced by a new currency.

Denomination is the enlargement of price scales, that is, the reduction of "0" in the monetary unit and the decrease in the nominal value expressed in the currency.

Money reformation usually can be conducted by the following ways:

- 1) Exchange of old money for new money at the rate of deflation in order to reduce the money supply in circulation;
- 2) Temporarily keep the bank deposits of the population and enterprises unmoved (completely and partly).

Applying these two ways to reform money circulation is internationally known as "Shock Therapy".

The main task is to increase the purchasing power of the soum and ensure its stability in strengthening the national currency in the country. This can be achieved by filling the

market with competitive products and creating necessary precautions. Filling the market with consumer goods requires the country to expand national production and improve product quality. By this the share of the national products in the total sale of consumer products can be expanded. It should be noted here that ensuring the stability of the Soum by expanding the national production does not deny the import of products from abroad. In order to provide the population with qualitative foreign products imports are also encouraged.

Stable functioning and exchange of the soum for any foreign currency depends on the availability of sufficient currency reserves. It is especially important to create incentives for businesses and enterprises to make competitive products for the world market. Careful and cost-effective utilization on ensuring the stability of the Soum plays an crucial role to achieve cost-effective investment and the timely repayment of loans.

Implementation of a clear policy against inflation is one of the most important conditions for strengthening the national currency. This policy should be aimed at drastically reducing inflation. In doing so harsher control over the level of money depreciation and the adoption of effective countermeasures are crucial. In the result, optimum rate of money depreciation can be chosen.

An anti-inflation policy should be based on measures to link the growth of the monetary value to the appropriate increase in the volume of goods and services. Because the excessive amount of money at the hands of the population, which is insufficient for the purchase of goods, will lead to further inflation and eventually, crisis. Increased prices, along with the amount of money, will inevitably lead to long-term hyperinflation. This, in its turn,

creates a threat to national production, the widespread poverty of the population, and the disruption of the entire social system.

In the sustainability of soum it is of paramount importance to decrease money emission and prevent money being left in the hands of the population unmoved. At the same time, measures should be taken to return the money at the circulation and to prevent the issuance of loans to enterprises that do not ensure sufficient growth of production.

A strong factor in reducing inflation is achieving stabilization of the national currency exchange rate. This, in turn, leads to the stabilization of the prices of imported goods, which will result in change of prices on domestic markets.

Determination of the single exchange rate formed as a result of supply and demand for all types of foreign exchange operations on foreign exchange markets is the prerequisite for achieving the stability of the exchange rate.

Thus, successful implementation of the above measures and procedures will have a positive impact on the stabilization of the national currency exchange rate and the growth of its purchasing power.

The “original” living standard figures in CIS calculated at official exchange rates give very low GDP per capita results in US dollars. The average figure is about \$ 4.200 in 2016. In comparison, it can be mentioned that the equivalent figure in Germany was \$ 42.000, according to the World Bank (World Development Report, 2018). Thus, in this comparison, Germany’s living standard seems to be about ten times higher, than the CIS average. If we pay attention to the GDP per capita calculated in the official exchange rate there will be a huge difference between the leader country (Russia) of the group with \$ 8.748 and the follower country (Tadjikistan) with just \$ 795 per capita. At the first glance we can say that GDP per capita in Russia is 11 times more than in Tadjikistan. But these figures tell very little about relative price levels.

The original GDP figures per capita in CIS countries are low, or even extremely low, which means that official exchange rates reflect relative price levels very imperfectly. Therefore, PPP adjusted figures assume considerable importance.

After the PPP adjustment, the average living standard (GDP per capita) is almost four times higher, than the original figures presuppose. This means that currencies in CIS countries are grossly undervalued.

When a person of a CIS country travels to the West, he/she pays an undervaluation “penalty” when buying Western currency: the “price” of euro or dollar is three times higher than the PPP adjusted exchange rate presupposes.

It is occasionally maintained that undervaluation of a currency means “exchange rate protectionism”: it creates price competitiveness to exportable of the country, and keeps importable expensive (in terms of local currency). Undervaluation of a currency helps visible and invisible trade components in

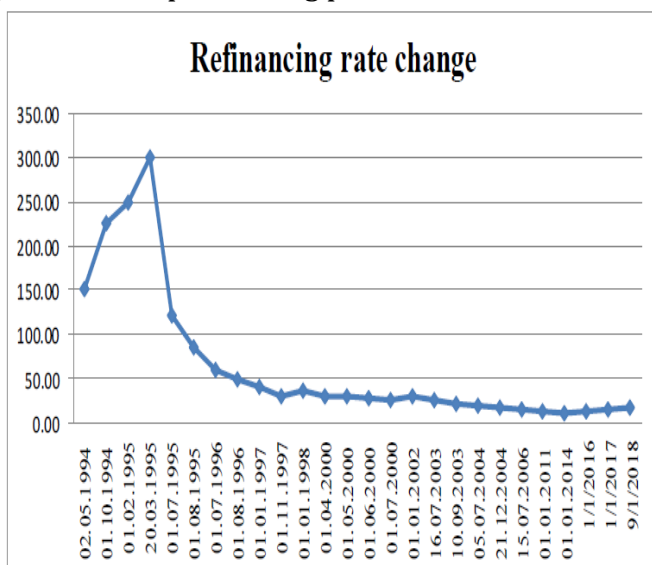


Diagram 1.

Source: The calculations of the authors based on the datas of the Central Bank of the Republic of Uzbekistan.

the balance of payments on current account to be in equilibrium. Emerging markets, like transitional economies, have very often undervalued currencies.

Taking into account similar problems in Uzbekistan, on September 2, 2017 the President of the Republic of Uzbekistan signed the Decree No. VII- 5177 "On Priority Measures on the liberalization of foreign exchange policy". This Decree is aimed a fundamental reform of the existing system of currency regulation, liberalization of the monetary policy, creation of equal conditions for all business entities in carrying out foreign trade activities.

The adoption of the Decree of the Republic of Uzbekistan was caused by a number of problems and deficiencies that impede the country's export potential, improve the business and investment climate, and attract current investments.

In particular, excessive administrative interference in foreign currency regulation, foreign trade activities, existence of some certain privileges and preferences for some sectors of the economy and economic entities have created unequal conditions for doing business among enterprises, and the parallel foreign exchange market as well as exchange rate have been appeared.

In accordance with the Decree of the Republic of Uzbekistan dated September 2, 2017 No. VII-5177 the resident of the Republic of Uzbekistan has the right to sell foreign currency to foreign currency exchange offices and purchase them from conversion department and utilize them on abroad without any restrictions.

In order to strengthen the position of the national currency as a single payment instrument, it was forbidden to make payment in foreign currency for goods and services in the Republic of Uzbekistan. It was noted that

this Decree stipulates the establishment of prices and tariffs for goods and services as well as the minimum requirements for the authorized capital of the companies only in national currency.

In regard this, settlements on transportation expeditions (regardless of the place of delivery) in the territory of Uzbekistan are carried out only in the national currency of the Republic of Uzbekistan.

At the same time, payment for services of foreign transporters is a current international operation and the purchase of foreign currency by resident legal entities is approved by the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan dated July 10, 2001 No. 294 "Regulations of the procedure for conducting operations on purchase and sale of foreign currency on the OTC".

Apart from that the Decree sets up a number of norms aimed at consolidation of confidence in the national currency, as well as abolition of conditions when goods (works and services) in the Republic could be purchased for foreign currency, which entailed the need for its acquisition by legal and physical entities. It has been defined in particular that:

1. It is prohibited to make payments in foreign currency for goods (works and services), with the exception of payments through international payment cards in compliance with the international practices. At the same time, for the purpose of creating favorable conditions for the development of entrepreneurial activities, this Decree authorizes repayment of loans issued in foreign currency in national or foreign currencies, based on the credit policy and on the basis of an agreement reached by the parties.
2. Prices and tariffs for goods, works and services, as well as minimum requirements to the companies' statutory capitals shall be determined only in the national currency;

3. State duties, fees and such other mandatory payments shall be collected only in the national currency, with the exception of consular fees.

In agreement with the decision of the Board of the Central Bank of Uzbekistan there have been changes in the procedures of accountancy of foreign currency kept by commercial banks (October 22, 1998 No.511)

According to the above amendments and addenda, in order to ensure that individual entrepreneurs and farms, operating without the creation of a legal entity earning in foreign currency, freely dispose of their funds, have been granted the right to receive foreign currency in cash.

The Central Bank has analyzed the work to be done to overcome possible negative consequences of the credit portfolio of the commercial banks in foreign currencies as a result of liberalization of the exchange rate.

Taking into account the fact that all payments within the country are to be made in national currency as well as for the prevention from illegal and speculative operations, the procedure for the purchase of foreign currency which legally allow to buy the needed currency has been introduced.

Within the framework of the monetary policy, the dynamics of the exchange rate is formed by the internal and external factors affecting the supply and the demand for foreign currency.

Internal factors affecting the exchange rate include the monetary policy carried out in the country, exchange rates of the population and entrepreneurs, and inflation expectations. Particularly, the Central Bank can influence the level of supply and the demand for foreign currency by preventing high rates of money supply through the implementation of a relevant monetary policy and increasing the attractiveness of assets in national currency. At the same time, the instruments of monetary

policy are actively used by applying liquidity to or withdrawal of the banking system, changing reserve requirements for commercial banks and other measures on the current refinancing rate.

As a result of the Central Bank's analysis of the work that needs to be done to overcome possible negative consequences of the credit portfolio of commercial banks on foreign currency in the result of liberalization of the foreign exchange rate, the Central Bank suggests:

- Studying the possibility of repaying these loans together with each client who receives credit in foreign currency;
- Reconsidering the issue of changing terms of the contract related to prolonging repayment data, if the client's cash flow does not meet its obligations under current loan agreement.

In accordance with the Article 122 of the Constitution of the Republic of Uzbekistan, Article 11 of the Law "On the Fundamentals of State Independence of the Republic of Uzbekistan", Resolution of the Supreme Council of the Republic of Uzbekistan on September 3, 1994 No. 952-XII and the Presidential decree of the Republic of Uzbekistan on June 16, 1994 from July 1, 1994 the national currency of the Republic of Uzbekistan "Soum" was introduced into legal circulation on the territory of the Republic of Uzbekistan.

National currency is a national pride, one of the symbols of the state independence, and a sign of the sovereign state. The introduction of the national currency is one of the main conditions of economic stability, which has created a precise mechanism for the implementation of fiscal and monetary policies and economic policies that are in line with the interests of Uzbekistan.

Currencies circulated in the Republic of Uzbekistan in 1994-2019 Of the Central Bank of the Republic of Uzbekistan:

- On July 1, 1994, the national currency of the Republic of Uzbekistan in the amount of 1, 3, 5, 50 and 100 soums denominated banknotes (paper money) and metal coins with 3, 5, 10, 20 and 50 tiyin were put into circulation;
- On March 1, 1997, banknotes worth 200 soums and metal coins in the amount of 1, 5 and 10 soums were put into circulation;
- On October 20, 1999, the memorable metal coins in the amount of 25 soums dedicated to the 800th anniversary of Jaloliddin Manguberdi were put into circulation;
- On May 15, 2000, metal coins worth 1 soum were put into circulation;
- On June 1, 1999, the banknotes worth 500 soums were put into circulation;
- On September 1, 2001, the banknotes in the amount of 1000 soums and the coins of 5, 10 and 50 soums devoted to the 10th anniversary of the Republic of Uzbekistan were issued;
- On November 1, 2002, metal coins of 50 soums dedicated to the 2700th anniversary of Shahrisabz were put into circulation;
- On July 1, 2005, metal coins of 100 soums devoted to the 10th anniversary of the national currency of the Republic of Uzbekistan were issued;
- On September 1, 2009, metal coins of 100 soums devoted to the 2200th anniversary of Tashkent were issued two types;
- On September 1, 2011, metal coins worth 500 soums devoted to the 20th anniversary of the Republic of Uzbekistan were put into circulation;
- On July 1, 2013, banknotes with the value of 5000 soums were put into circulation;
- On July 1, 2017, banknotes with the value of 10 000 soums were put into circulation;

- On July 1, 2018, banknotes with the value of 50 000 soums were put into circulation;
- On February 1, 2019, banknotes with the value of 100 000 soums were put into circulation.

By the end of 2018, the current account deficit was 3.5 billion dollars. The main reason for the formation of the deficit was the higher level of growth rates of the imported goods over the growth rates of the exported goods. As a result of increasing demand for products by the consumers and entrepreneurs they are directed to the market. Moreover, formalization of the secret economy continues to have an impact on imports.

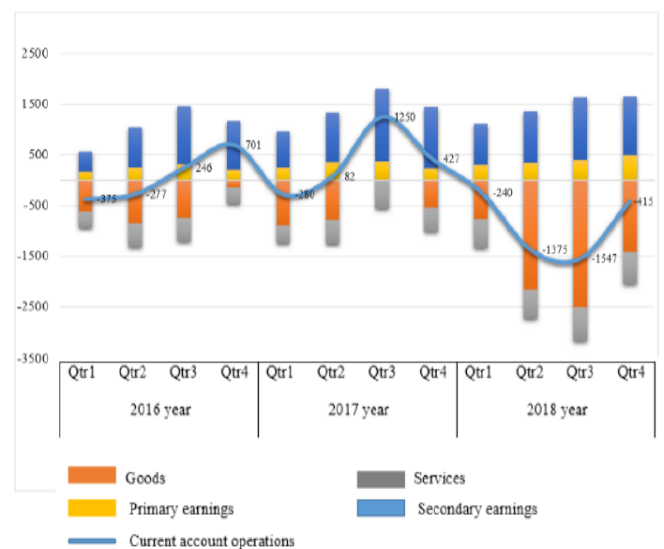


Diagram 2. Balance of current account components (million \$)
 Source: <http://cbu.uz/uzc/press-tsentr/obzori/2019/03/162514/>

At the same time, the decline of the growth rate of primary and secondary incomes observed in the second half of 2018 in comparison with 2017 due to the weakening of the currencies of countries receiving labor migrants and recipients of transboundary money transfers.

Net change in currency and deposits of the banking sector (changes in representation accounts and bank offices) has been remaining generally negative from the fourth quarter of

2017. The current tendency is the result of the increase in the volume of payments on residents' import operations.

In 2018, revenues and expenditures have increased across all components of current account operations. Simultaneously, for the first time the growth of current expenditures was higher than the growth of current revenues for all components due to the increase in imports. (table 2.)

Table 1. Current income and expenditure structure (mln.\$)

Indicators	2016	2017	2018	From them:			
				Q1	Q2	Q3	Q4
Current income	16 490,0	19 827,1	22140,1	5 152,0	5 035,8	5 003,0	6 949,3
Export of goods	8 645,2	10 161,5	11 85,6	2 956,9	2 350,8	1 976,5	4 101,3
Export of services	1 904,7	2 250,7	2 749,6	572,8	687,5	750,8	738,5
Estimated primary earnings	2 212,9	2 598,8	3 181,2	685,1	829,9	871,2	794,9
Estimated secondary earnings	3 727,2	4 816,1	4 823,8	937,1	1 167,6	1 404,5	1 314,5
Current expenditures	16 194,8	18 347,1	25 16,8	5 392,4	6 410,7	6 549,7	7 364,1
Import of goods	11 037,3	12 377,3	18 252,4	3 727,8	4 519,7	4 488,9	5 516,0
Import of services	3 443,7	4 092,5	5 191,1	1 142,6	1 249,1	1 417,3	1 381,9
Estimated primary earnings	1 278,5	1 384,2	1 658,1	385,56	484,8	481,6	306,1
Estimated secondary earnings	493,4	493,1	615,2	136,3	157,04	161,78	160,07
Current account balance	313,4	1 488,2	-3 76,7	-240,4	-1 374,8	-1 546,6	-414,9

Source: <http://cbu.uz/uzc/press-tsentr/obzori/2019/03/162514/>

In the result of the negative trade balance (more than three times) in the value of 6.9 billion dollars (\$2.2 billion in 2017) deterioration in the current account operations occurred in 2018. Moreover, in comparison with the growth rate of exports the growth rate of imports was higher (without the export of gold) in each term of 2018.

Thus, the negative balance of trade by the end of 2018, taking into account international services , amounted to 9.3 billion dollar. The positive balance of primary and secondary revenues was 5.8 billion dollar.

Table 2. Financial income and expenditure structure

	2016	2017	2018
Financial account	381,1	-443,8	-4 373,3
Net financial asset acquisition	3 432,4	3 296,3	856,9
Foreign direct investments	5,8	9,0	1,9
Portfolio investments	-	-	-
Other investments	2 874,2	3 543,3	2 418,6
From them			
Currency and deposits	3 609,4	3 201,2	1 716,0
Trade credits and advances	-735,2	342,1	702,7
Reserve assets	552,4	-256,0	-1 563,7
Net financial liabilities acquisition	3 050,3	3 739,1	5 230,1
Direct investments from abroad	1 662,6	1 797,3	624,3
Portfolio investments	1,9	2,9	13,0
Other investments	1 386,7	1 939,7	4 592,8
From them			
Loans and debts	1 230,9	930,8	2 144,8
Trade credits and cash loans	263,1	531,1	2 587,5
Other creditor liabilities -	-111,5	374,7	-148,7

Source: <http://cbu.uz/uzc/press-tsentr/obzori/2019/03/162514/>

The negative balance of financial account was 4.4 billion dollar by the end of 2018. At the same time, in comparison with the assets the liabilities increased more than six times. The main reasons for the sharp change in the balance of financial account compared with previous year are the growth of trade credits and income obligations (2.6 billion dollars) and loans and borrowings from non-residents (2.1 billion dollars). Moreover, additional 1.5 billion dollar was also utilized.

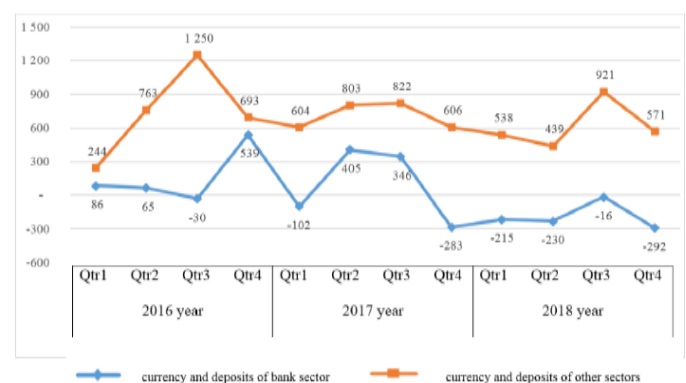


Diagram 3. Net changes by the component of "Currency and deposits"
Source: <http://cbu.uz/uzc/press-tsentr/obzori/2019/03/162514/>

Analysis of a component of “Currencies and deposits” by sectors of economy has shown that as the population accounts for the increase in foreign currency reserves the main parts of the operations accounted for other sectors of the economy. Continuous increase of assets is ensured by the repatriation of incomes (transfer to Uzbekistan) of the citizens of the Republic of Uzbekistan working abroad, as well as funds transferring into the foreign current accounts of legal entities.

Balance of the operations of trade loans and prepayment transactions by non-residents on foreign trade agreements has been positive for 2017-2018. At the same time, in 201 this figure doubled compared with 2017, and according to the estimates experts this increase is partly due to an increase in foreign trade turnover by 22% in 2018.

According to the “Other Investments” article, increase of net liabilities by 2018 amounted to 4.6 billion dollar (\$1.9 billion in 2017). The major share of this growth was accounted for the components of “Loans and borrowings” and “Trade credits and prepayments” (*creditor debt*), and they appropriately increased by 2.1 billion dollar and 2.6 billion dollar.

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