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PECULIARITIES OF INFLATION TARGETING IN OUR COUNTRY

***Abstract**: This article describes the measures taken by our country on the specifics of the implementation of monetary policy in Uzbekistan and the economic results achieved as a result of these measures. In our country, specific and appropriate scientific proposals and recommendations for inflation targeting are given.*

***Key words**: inflation, regulation, inflation targeting, core inflation, inflation prevention, central bank, monetary policy, price, inflation rate, commercial banks, economic growth, required reserve ratio.*

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Introduction

According to official statistics from the International Monetary Fund, the number of countries using the inflation targeting regime in 2018 is 41, of which 30 are developing countries. In order to achieve the inflation target, monetary policy mechanisms will be gradually transferred to this regime, which will be used as an effective tool to reduce inflation. In turn, the application of this regime can create additional conditions for strong and sustainable economic growth in the medium term by ensuring price stability. At the same time, the Central Bank identifies the most appropriate inflation target and achieves it through the use of monetary policy instruments, regular analysis of economic development and extensive coverage of monetary policy plans.

The point is that low and predictable (stable) inflation is a very necessary factor for sustainable economic growth in the country. Consequently, inflation expectations are added to the interest rate when lending by commercial banks, and high inflation expectations lead to higher lending interest rates. Thus, the high (under the influence of high inflation) interest rates charged by entrepreneurs for the use of borrowed funds (loans) affects the payments associated with their repayment.

If interest rates (calculated for the loan) are high, entrepreneurs will receive less credit. This has a negative impact on long-term economic growth, affecting their investment ability. After all, the investments we make today will serve as an important tool in creating the main sources of production that will be used in the production of goods and services in the future.

The inflation targeting regime allows achieving several macroeconomic goals:

• prevention of sharp rise in prices and high inflation;

• formation of the money market, elimination of the causes of money market segmentation;

• Supporting the solvency of the population and entrepreneurs, taking into account internal and external factors, and ensuring the stability of the financial sector.

According to IMF experts, there should be two conditions for using inflation targeting as an indicator of monetary policy. First, the Central Bank must be able to pursue an independent monetary policy. The central bank should have the right to freely choose monetary instruments to achieve the inflation rate that the government deems acceptable. The requirements of fiscal policy in the country should not be taken into account as a priority in the development of monetary policy. In other words, there should be no concept of 'budget hegemony' in the country.

Second, in order for the inflation target to be selected as an indicator, it is not necessary to set targets on wage growth, employment rate and exchange rate. This is because the determination of the exchange rate of the national currency against the foreign currency forces the Central Bank to adjust its monetary policy to meet this indicator. This, in turn, does not allow the Central Bank to freely and fully use monetary instruments to meet the inflation target. As a result, the content of the tactical goals of monetary policy is ambiguous and contradictory.

Countries that have successfully used inflation targeting include New Zealand, Canada, the United Kingdom, Finland, Sweden, Australia and Spain. In Australia, Finland and Sweden, the central bank announced inflation targets without the government's consent to support them. In Canada and New Zealand, an 18-month period is set to reach the target. At the end of this period, a new 12-month period is set in New Zealand and an 18-month period in Canada in order to gradually reduce inflation. After the expiration of the new deadlines, both countries managed to achieve the inflation target, and both countries set the inflation target for another five-year period. In Australia, Finland, the inflation target is taken as the exact level. In Canada, New Zealand, Sweden, and the United Kingdom, the inflation target is set as a corridor.

The inflation targeting regime used by the Central Bank of Russia had set a goal of raising the annual inflation rate to 4% by the end of 2017. The measures taken in 2016 made it possible to achieve this goal. That is, at the end of 2016, the annual inflation rate in Russia was 5.4%. However, as of December 31, 2015, the annual inflation rate in Russia was 12.9%. By June 2016, a significant reduction in inflation had allowed the Central Bank of Russia to lower its refinancing rate. The factors that ensured the effectiveness of inflation targeting in Russia in 2016 are:

1. Ensuring low growth rates of prices for products and services of natural monopolies. In 2016, the growth rate of these prices was 1.3%.

2. Stability of the nominal exchange rate of the national currency (during 2016, 1 US dollar was provided at the level of 64-67 rubles.).

3. Ensuring a low growth rate of money supply. In 2016, the growth rate of money supply (per monetary aggregate M2) was 9.2%. In 2015, the growth rate was 11.5 percent.

4. The increase in the monetary base through the financing of the state budget deficit at the expense of the Reserve Fund was not allowed (it was allowed in 2015).

As the inflation target in Kazakhstan is for the medium term, the econometric analysis is based on the analysis of data for the quarter. In order to increase the accuracy of the forecast, surveys are being conducted among the population to assess inflation and devaluation expectations.

At present, due to the inflation targeting regime in Kazakhstan, the targets for the exchange rate of the national currency have not been set. The national currency, the tenge, has a free-floating regime.

The transition to inflation targeting is considered one of the priorities in the fight against inflation at the stage of transition of the economy of the Republic of Uzbekistan to a modern, innovative path of development.

The Resolution of the President of the Republic of Uzbekistan dated September 13, 2017 No. RP-3272 "On measures to further improve monetary policy" identifies a number of important measures to improve monetary policy. In particular, in accordance with this Resolution, the proposal of the Central Bank of the Republic of Uzbekistan to move to the inflation targeting regime applied by foreign central banks was approved.

In accordance with the Decree of the President of the Republic of Uzbekistan dated November 18, 2019 DP-5877 "On improving monetary policy through the gradual transition to inflation targeting", the Central Bank of the Republic of Uzbekistan and the Ministers for the introduction of inflation targeting The task of the Cabinet is to carry out coordinated preparatory work in the following areas:

- gradual reduction of the role of non-monetary factors of inflation, including reform of tariff regulation, ensuring the effectiveness of structural economic reforms in the real sector of the economy and filling the domestic market with consumer goods;

- Improving the quality of macroeconomic analysis and communication policy of the Central Bank;

- introduction of new instruments of money market regulation, ensuring the effective influence of the regulator on the credit market.

According to the Decree, in order to expand the use of market mechanisms and instruments of economic regulation to ensure macroeconomic stability, as well as to radically increase the effectiveness of monetary policy, the Central Bank of Uzbekistan aims to reduce inflation to 10% in 2021 and 5% in 2023.) to ensure the gradual transition of monetary policy mechanisms to the inflation targeting regime from January 1, 2020.

The Decree also approved the Concept of joint action of the Cabinet of Ministers and the Central Bank of the Republic of Uzbekistan to reduce inflation and ensure price stability, and in accordance with this

Concept approved a "Roadmap" to reduce inflation and ensure price stability in 2020.

It is noteworthy that from January 1, 2020, the interest rates on all types of new loans issued by commercial banks (in the national currency), including loans under government programs, will be set at no less than the refinancing rate of the Central Bank (state mortgage lending programs and (except for loans to agricultural producers for the cultivation of raw cotton and cereals) and from January 1, 2021, if necessary, loans to commercial banks with the right to set interest rates independently through the introduction of mechanisms to compensate a certain part of interest expenses the practice of granting preferential interest rates has been abolished.

It should be noted that for the first time in the history of our country, a normative requirement on the state budget deficit has been introduced. That is, the Ministry of Finance of the Republic of Uzbekistan is tasked to ensure a gradual reduction of the fiscal balance deficit to no more than 1.5% in 2022.

As a result of the monetary policy implemented in accordance with the Decree of the President of the Republic of Uzbekistan "On improving the monetary policy through the gradual transition to inflation targeting", by 2021 inflation was formed at the intermediate target level - 10%.

The main factors that created the inflationary environment over the past year were a significant increase in food and energy prices. The rise in prices is explained, on the one hand, by global inflation trends and, on the other hand, by reasons related to competition and supply in the domestic market. The core inflation rate also fell to 8.8 percent by the end of 2021, the lowest level in five years. According to a survey conducted in December last year, inflation expectations of the population and entrepreneurs for the next 12 months shifted to a downward trend after the upward trend in September-November and amounted to 15.7 and 14.9 percent, respectively.

At the same time, respondents cited rising gasoline prices, rising transportation costs, rising prices for basic foodstuffs and imported goods as the main factors of inflation expectations. Overall, last year was a year of economic recovery after a sharp decline in 2020. According to preliminary data, in 2021, the gross domestic product will grow in real terms by 7.4%. At the same time, fiscal expenditures directed to the economy and loans from commercial banks were the main factors supporting economic and investment activity. While the loans allocated to the economy by commercial banks last year increased by 31% compared to 2020, the loan repayment rate improved significantly to 71%. Loans to individuals also grew by 42%, serving to support the population's demand for consumer goods and mortgages.

According to estimates, the impact of high fiscal stimulus in 2021 will continue in 2022, and from the second half of the year, economic growth rates will approach their long-term indicators, namely the potential growth rate.

The year 2021 was shaped by the acceleration of global inflation as a result of rising food and energy prices and the tightening of monetary conditions in most developing countries. At the same time, inflationary processes, initially recognized as temporary, suggest that end-of-year uncertainties and pandemic risks could put pressure on prices over the long term.

Although there were no significant fluctuations in the currencies of major trading partners (except Turkey) over the past year, inflation in them has been sharp.

At the end of 2021, the devaluation of the soum exchange rate was 3.4%, the lowest level in three years.

In this regard, the increase in export revenues and cross-border remittances by 34% in 2021, respectively, was a factor supporting the supply of foreign exchange in the domestic foreign exchange market and contributed to a 1.6-fold increase in total supply in the market. At the end of 2021, the situation in the money market was relatively stable, with Uzonia and Uzwia averaging 13%. During the year, the dynamics of interest rates in the money market reflected the almost double volume of interbank transactions and a sharp increase in the activity of monetary instruments.

In general, the activation of monetary instruments in the regulation of liquidity over the past year, in turn, led to a significant increase in costs and liabilities of the Central Bank.

The average weighted interest rates offered by banks on time deposits in the national currency in December amounted to 20.2% for individuals and 15.1% for legal entities, respectively, which created a positive difference in inflation expectations.

This, in turn, increased the total time deposits in soums by 1.5 times last year, including those of individuals. - 1.7 times growth.

In the last months of 2021, the balance of interest rates on loans in the national currency was also balanced, within the corridor of 20-22%, which has been observed since the beginning of the year. In particular, in December, the average weighted interest rates on short-term loans in the national currency amounted to 21.2% and 20.5% on long-term loans.

According to the basic scenario of macroeconomic development, this year the Central Bank intends to maintain relatively stable monetary conditions.

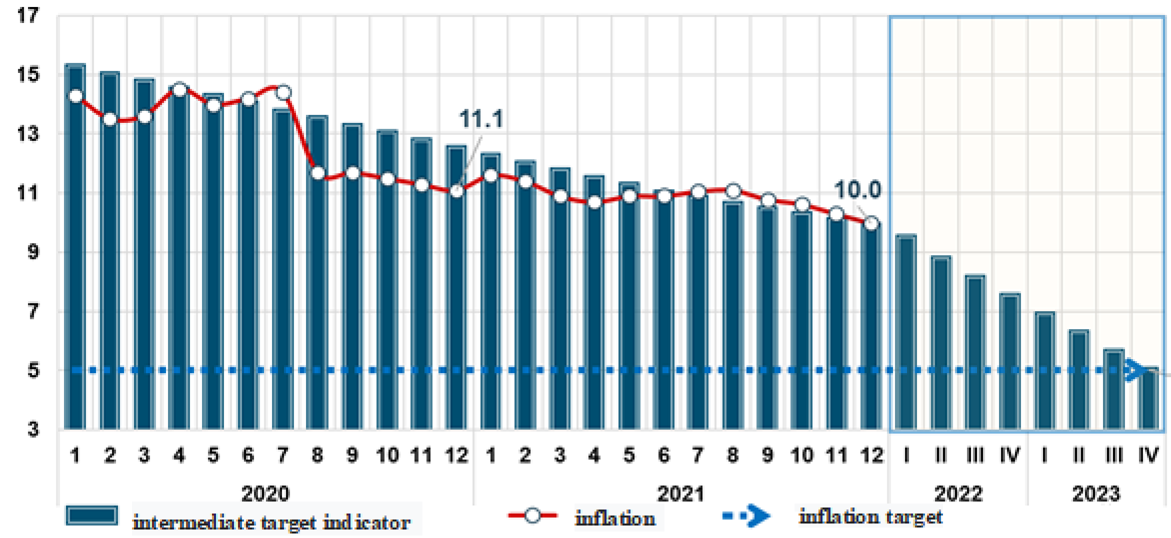
Given the continuing global inflation, the risks associated with rising prices for raw materials and energy resources in foreign markets, the pandemic situation, the slowdown in global economic growth suggest that the inflation rate may be in the range of 8-9% by the end of this year.

It is also projected that real GDP growth in 2022 will be around 5.5-6.5 percent. At the same time, the past fiscal stimulus aimed at the economy in 2020-2021 will be one of the main factors supporting economic activity in the first half of 2022.

The current monetary conditions are calculated in accordance with the forecasts of macroeconomic indicators, and in the future, as the inflation forecast decreases, there may be opportunities to reduce nominal interest rates, leaving real interest rates unchanged.

In December 2021, the consumer price index increased by 1.3% (December 2020 - 1.6%). Overall, the annual inflation rate slowed to 1.1 percentage points compared to the corresponding period of 2020 and at the end of the year It was formed within the target set for 2021 at 10 percent (Figure 1).

Figure 1. Inflation target and its trajectory (annual, in percent)



Source: State Statistics Committee data and Central Bank forecasts

Last year, the growth of prices for structurally non-food products and services slowed to 7.8 and 7.7 percent, respectively, which is one of the main factors contributing to the decline in annual inflation.

Although the annual indicators of food prices were formed in a declining dynamics (in December 2020 - 15.3%, in December 2021 - 13%), they served as a major driver of overall inflation (5.5% busy).

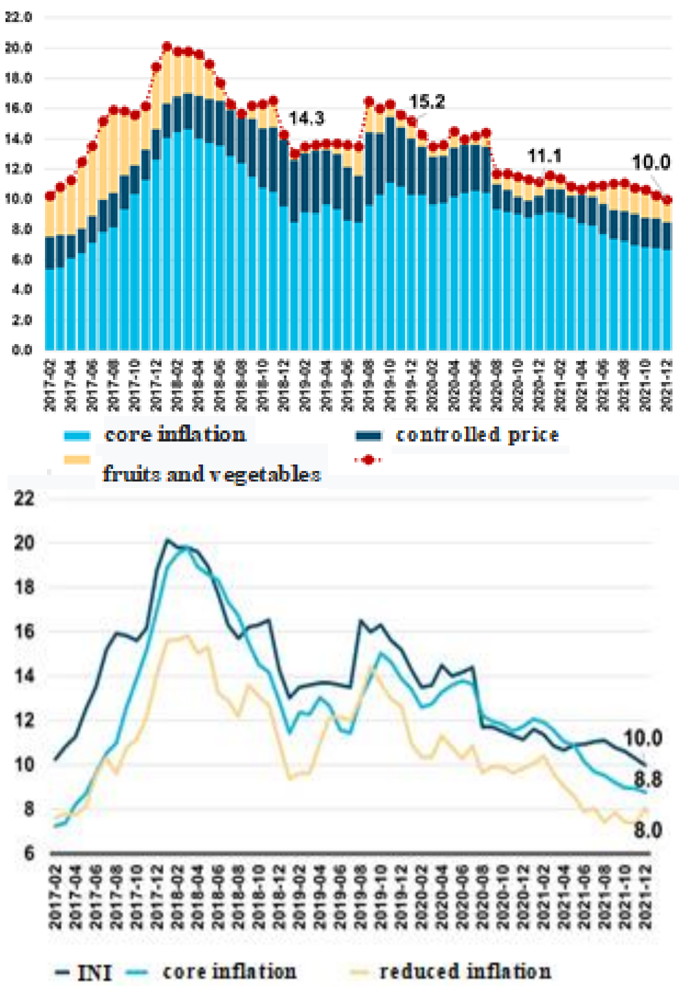
In the IV quarter of 2021, the quarterly growth of food products and services was lower than in the corresponding period of 2020, while in non-food products, on the contrary, the growth of prices accelerated slightly.

This is due to the significant rise in gasoline prices in the domestic market, as well as against the background of logistics problems, the increase in production and delivery costs has maintained an increasing effect on the prices of most non-food products until the end of the year.

The central bank's core inflation rate formed on a declining trajectory during the year, reaching 8.8 percent, the lowest level in five years. At the same time, the contribution of core inflation to total inflation slowed to 6.7 percentage points (Figure 2).

It should be noted that the slowdown in core inflation on an annual basis can be explained mainly by the declining fundamental trend in the prices of most food and non-food products, as well as services.

Figure 2. Basic and reduced inflation dynamics, annual



Source: Central Bank calculations based on data from the State Statistics Committee

Also, the reduced inflation rate in December was slightly faster than in previous months, at 8 percent on an annualized basis. The gap between general and declining inflation has narrowed to 2 percentage points, indicating that the volatility of consumer prices is gradually declining.

One of the main instruments of monetary policy to keep inflation in the inflation targeting regime is the basic rate set by the Central Bank. The central bank can influence the interest rates offered by commercial banks on deposits and loans by changing the base rate. This, in turn, affects the price level in the economy through aggregate demand.

The Central Bank of the Republic of Uzbekistan is gradually transitioning to the inflation targeting regime, and in 2023 it is planned to achieve the inflation target of 5%.

Taking into account the above analysis and considerations, we make the following recommendations: In order to implement the inflation targeting regime, first of all, the following conditions must be met:

• setting a permanent inflation target and communicating it to the general public (regularly informing the population about inflation, its factors and the intended inflation target);

• extensive use of monetary policy instruments (REPO and currency swap auctions, deposit auctions, and Central Bank bond auctions) to manage inflation and regulate interest rates in the money market;

• detailed macroeconomic analysis for making objective decisions in the field of monetary policy (analysis of the state of business entities: households, entrepreneurship, public administration and the outside world) and forecasting based on open data available in domestic and foreign markets;

• improving communication policies to provide the general public with the objectives of monetary policy (price stability, credit popularity, low inflation, increasing public confidence in the national currency, etc.), the ability to forecast the macroeconomic situation and build market confidence.

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