URGENT ISSUES IN MAINTAINING THE STABILITY OF THE NATIONAL CURRENCY SYSTEM

A. Ismailov
Tashkent Financial Institute, 7, Kichik Halka Yuli Str., Tashkent 100060 Uzbekistan
alisher_bankir_595@mail.ru

Abstract. Development of the national monetary system necessitates the ensuring of stability of the national monetary system. This is explained by the fact that the national currency system has a direct impact on the competitiveness of the national economy, on the export potential of the country and the living standard of the population. Appreciation of the real exchange rate would cause the rising of export cost and artificially overvalued exchange rate will provoke the emergence of excessive demand for foreign currencies in the country. Moreover, relatively high devaluation level of national currency would negatively affect the efficiency of financed investment projects. This article analyzes the current state of monetary system of the Republic of Uzbekistan, identifies the current problems and proposes scientific and practical solutions to identified problems. In particular, the author justifies the need for the transfer of all foreign exchange reserves of the state to the balance sheet of the Central Bank with the right to self-governance within the framework of monetary policy. Increasing the diversification level of foreign exchange reserves of the Central Bank is proposed by restructuring the currency framework of external debt of the Government of Uzbekistan.

Keywords: currency, exchange rate, exchange rate parity, currency exchange, foreign debt, devaluation, diversification, gold and currency reserves, conversion transactions, swaps, reserve requirements.

Introduction

National currency system, being an essential part of national monetary system, plays an important role in the maintenance of stability of the national currency, and also in the progress of the international currency relations of a country as a whole. Furthermore, an effective regulation of national currency system ensures the required level of currency liquidity of the country.

However, in the condition of intensifying world financial-economic crisis, a number of problems connected with maintenance of the stability of national currency system of Uzbekistan are observed. In particular, the devaluation of national currency still remains at high level: 10.5% as of 2012 and 11% as of 2013 (Main directions of money-credit policy in 2014, www.cbu.uz) in the face of a decline of official foreign reserves of the country due to the high demand for hard currency and intensive currency intervention policy by the Central Bank of the Republic of Uzbekistan.

Due to the suspension of the trade with cash foreign currencies in territory of Uzbekistan (Resolution of the President of the Republic of Uzbekistan № 1914, 30.01.2013) starting from February 1, 2013, experts and scholars believe that these events bring to the growth of the foreign currency transactions out of the banking sector that is in the parallel (black) market. The reason is that in the country prevails the dollar fetishism, particularly for the purchase and sale of real estate and other similar products, cash foreign currencies are widely used (primarily the U.S. dollar and euro) by most people.

In addition to that, high reserve requirements are used by the Central Bank of Uzbekistan to commercial banks on time deposits in foreign currency. As of January 1, 2013, the rate of the required reserve on time deposits with the term up to one year was 15% (Money-credit policy, www.cbu.uz).

In connection with the aforementioned, researching and seeking the solutions for these problems will certainly lead to the stability of country’s payment system.

Chapter I. The Current state of national currency system of Uzbekistan

The modern national currency system of Uzbekistan has been created in 1994 after the introduction of national currency in circulation (Decree of the President of the Republic of Uzbekistan № 870 dated 16.06.1994). The nominal exchange rate of the national currency – “sum” is mainly defined relative to US
dollar. This is explained by the fact that the currency reserves of Uzbekistan basically consists of US dollars. The nominal exchange rate of sum is formed at the Republican currency exchange on the basis of supply and demand for US dollars. It is necessary to underline that in Uzbekistan applications for conversion are submitted mainly for obtaining US dollars, though starting from 2008 application in euro also started to be realized. However, their volumes remain low. Republican currency exchange of Uzbekistan is a closed joint-stock company. Traders of the currency auctions are only commercial banks, and representatives of other business enterprises are not allowed to the currency auctions. At present nominal exchange rate of national currency of Uzbekistan does not reflect real supply and demand for US dollars so far as the Central Bank actively interferes in the process exchange rate formation. As a result of this arises a substantial difference between nominal exchange rate of national currency and the exchange rate of the parallel market.

Besides that, the above mentioned problems are aggravated by the fact that there is no system of the uniform, centralized management of the official gold reserves in Uzbekistan. As the experience of foreign countries (U.S. and Japan) shows, the centralized control enhances the efficiency of the management of official gold reserves. Currently, the Central Bank of Uzbekistan is not able to improve the efficiency of the management of official gold and foreign exchange reserves of the country. The reason for that the Government of Uzbekistan has its own currency reserves. For example, in the country the Fund for Reconstruction and Development is established, which is controlled by the Ministry of Finance of Uzbekistan.

In developed countries of the world, the government have no currency reserves in foreign currencies, for instance in case of USA, Japan, Germany and France. All foreign currency reserves of the government are transferred into the balance of the Central bank. It is made to raise the efficiency of managing the official currency reserves. In this system, the governments have no capacity to excessively increase an external debt. Whereas, the Central bank pays for an external debt of the government at the expense of its own currency reserves in the balance within the limits of credit balance of the government’s current account in national currency. This payment system of the external debt does not give the chance for the government to excessively increase the size of an external debt, since the Central Bank, in the absence of the necessary resources in the current account of the government in national currency, does not accept the payment order in foreign currency issued by the government to pay the foreign debt.

However, in Uzbekistan the Government has reserves in foreign currencies. Just only in the Fund for Reconstruction and Development there are reserves in volume over 15,0 bln. of US dollars (Karimov, 2014, p.13). That’s why, the Government has the capacity to pay the external debt at the expense of its own reserves. Undoubtedly, in such conditions, the efficiency of managing the official currency reserves decreases, since the Central Bank does not have the opportunity to independently handle the official foreign exchange reserves. Apart from that, rather high level of demand on foreign currencies and devaluations of national currency negatively impact on the stability of currency system of Uzbekistan (the table).

### Table
**Dynamics of conversion operations and devaluation level in Republic Uzbekistan**
(Calculations of the author under the statistical data of the Central bank of Republic Uzbekistan)

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Change in 2012 compared to 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume of conversion operations at the Republican currency exchange, bln. of USD</td>
<td>11,5</td>
<td>13,8</td>
<td>13,7</td>
<td>119,1 %</td>
</tr>
<tr>
<td>Annual devaluation level of national currency relative to 1 USD</td>
<td>8,5</td>
<td>9,5</td>
<td>10,5</td>
<td>-2,0 items</td>
</tr>
</tbody>
</table>

It is apparent from the data on table №1, during the period 2009-2011, the volume of conversion operations at the Republican currency exchange has essentially increased. At the same time, during the analyzed period, the level of devaluation of national currency in regard to US dollar remained at high level. These facts indicate that in Uzbekistan exists a rather high level of unsatisfied demand for US dollars.

One of the main issues on stabilization of national currency system is the optimization of structure of currency reserves of the Central Bank. Usually, under the term of diversification it is understood the formation of currency reserves containing of several different currencies.

However, the capacity of the central banks for the diversification of currency reserves is limited because of the currency structure of an external debt of the government. For example, in Uzbekistan just over 80 % of an external debt of the government is generated in US dollars. In such conditions it is impossible to raise the
diversification level of currency reserves of the Central bank as the Government issues the payments orders in US dollars.

This kind of problem exists in many countries of the world. For example, in the currency reserves structure of Asian countries US treasury bonds have prevailing weight. And, in the currency reserves structure of the Central bank of India these bonds makes up 56% (Malishev, 2011, p. 34). The central bank of Uzbekistan carries out currency intervention policy on a spot market. Here the US dollar is used as the tool of currency intervention. However, due to lack of development of the futures transactions market, the Central Bank of Uzbekistan does not have the opportunity to use derivatives as instruments of currency intervention. Relatively low level of liquidity of current currency market appears to be the main reason for the underdevelopment of the futures transactions market, since all futures currency transactions upon the maturity date of the contract automatically become spot transactions. Therefore, many banks of different countries widely use instruments of futures market (derivatives). For example, the Central bank of Spain within 1993 sold “put” options on peseta in order to avoid its devaluation. The bank of Mexico in 1996 also sold “put” options on US dollars, with intention to accumulate currency reserves (Moiseev, 2011). Only the Central Bank of Colombia uses options during the intervention (in November 1999, it introduced permanent monetary instruments, two varieties of monthly options).

Owing to the various objective and subjective reasons, the US dollar is being used in Uzbekistan as the main foreign currency. However, in recent days instability of an US dollar exchange rate has been observed, as the Federal reserve system of the USA does not bear responsibility for the maintenance of stability of a dollar exchange rate. These problems are also deepened with the case that majority of foreign-trade operations are concluded in US dollars. In such conditions, it is almost impossible to facilitate the efficiency of optimal currency reserve structure in the banking sector.

Chapter II. Measures on maintaining the stability of currency system of Uzbekistan

In my view, in order to strengthen the stability of national currency system of Uzbekistan, it is necessary to take following measures:

1. All foreign currency reserves of the government, including, currency resources of the Fund for Reconstruction and Development should be transferred into balance of the Central bank with the discretion of managing independently within the limits of the monetary policy. As a result of this, the centralized management of official foreign currency reserves is provided and the government will not have the capacity to excessively increase the external debt. Because, the external debt of the government is to be paid at the expense of the foreign currency reserves in the balance of the Central bank within the limits of credit balance of the government’s current account in national currency in the Central bank. At present, problems related to foreign debt of the government do not exist in Uzbekistan. As it was noted by the president I.A. Karimov that as of January 1, 2017 the total external debt of the country did not exceed 17% of the GDP, which is by international standards treated as “less moderate” indebtedness. Still, in the current settlement system of an external debt, there exists a possibility of an excessive increase of the foreign debt of the government, as far as the size of to be paid external debt does not depend on the availability of the funds in national currency in the current account of the Government.

2. Intensive currency intervention should be refused either by means of increasing the volume of conversion operations or by devaluation of the national currency. Now, in the internal currency market of Uzbekistan there is a rather high demand for foreign currencies. Therefore, the Central bank is compelled to carry out intensive currency intervention that can lead to an exhaustion of currency reserves. In such circumstances, either increasing the volume of conversion operations or devaluation of the national currency facilitates to the reduction of a demand to foreign currencies. I think that increasing of the volume of conversion operations in currency the market is more desirable option. Since the devaluation of national currency negatively influences the efficiency of the financed investment projects. Under the severe devaluation, proceeds in the national currency obtained as a result of sale of the goods will not be enough for paying off the investment loans of banks provided in foreign currency for the financing of investment projects.

3. It is essential to raise the diversification level of currency reserves of the Central bank by updating the currency structure of external debts of the Government of Uzbekistan. Updating of the currency structure of external debts should be delivered by using the main reserve currencies of the world (US dollar, euro, pound sterling, Japanese yen and Swiss franc). As a result of our conducted analysis, we found out that over 80% of
the currency reserves of the Central bank of Uzbekistan are generated in US dollars. This is explained by the currency structure of the Government’s external debt. The US dollar still remains as the main reserve currency of the world. The majority of the international loans are provided in US dollars. For example, in May, 2010 the Asian Development Bank made the decision to allocate the credit lines to Uzbekistan in the amount of 1140 million US dollars (Asian Development Bank. Annual Report, 2011). Significant portion of these credit lines are secured by the guarantee of the Government of Uzbekistan. Besides, export-import contracts of companies in Uzbekistan, basically, are concluded in US dollars. Therefore, over 90% of applications for conversion on import contracts are submitted in US dollars. The current situation also influences the diversification level of currency reserves of the Central bank. Therefore, I think that the Ministry of Finance of Uzbekistan, with the purpose of increasing the diversification level of currency reserves of the state enterprises, should reconsider currency structure of export-import contracts of these enterprises. Because, in Uzbekistan, a considerable part of foreign trade operations falls on the share state enterprises. For example, in 2011, over 31% of the export fell on the share of those products which are exclusively produced by state enterprises. Increasing the diversification level of currency reserves of the state enterprises enables to a substantial increase of the diversification level of currency reserves of the Central bank of Uzbekistan.

4. The central bank of Uzbekistan has the opportunity to increase the supply of foreign currency by the application of swap operations with gold (GOLD SWAP). Now, Uzbekistan is one of ten leading countries which are considered as the main producers of the gold to the world market. Therefore, the Central bank of Uzbekistan has capacity to increase the supply of foreign currency in the internal currency market by the sale of gold on the terms of spot and its purchase on the terms of forward. The law “On the Central Bank of the Republic of Uzbekistan” allows the use of “GOLD SWAP” operations. However, the Central Bank of Uzbekistan is not taking the advantage of this opportunity for the time being.

Apart from that, in Uzbekistan, revenues in foreign currency received from centralized export, including from the export of gold is completely sold to the Central bank.

Conclusion

Rather high level of devaluation of the national currency, low level of devaluation of foreign currency reserves of the Central bank of Uzbekistan and increasing demand for foreign currencies in the internal currency market of the country are the actual problems associated with the provision of stability of the national currency system of Republic Uzbekistan.

Our proposals on increasing the stability level of the national currency system assist to resolve the above mentioned problems.

Introduction of centralized management of the official gold and foreign currency reserves, abandonment of the intensive currency intervention policy, raising the diversification level of currency reserves of the Central Bank by updating the currency structure of the external debts of the Government, expanding the supply of foreign currencies by the use of GOLD SWAP operations of the Central Bank will certainly assist for a significant increase in the stability of the national currency system.

References


Malishev, P. (2011) Characteristics of managing the reserve assets in Asian countries. World economy and international relations., (3) p. 34.


