

Peculiar Ways of Transforming Inflation in to Target Mode

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Abstract--- *Today, the world economy is changing rapidly. At the same time, in order to gain a foothold there is always a need for active economic growth and production of competitive goods. It faces various challenges in developing the economy. These are inflationary processes that result from price instability and, as a result, an increase in money demand in the economy.*

Keywords--- *Economy, Competitive, Increase, Money, Demand, Central Bank, Inflation, Target.*

"We economists don't know much, but we know how to create a deficit. If you want to create a tomato deficit, for example, all you have to do is pass a law that prohibits retailers from selling tomatoes for 2 cents per pound. You will immediately face a tomato shortage" It is the same with oil and gas.

Milton FRIDMAN,

Nobel laureate

I. INTRODUCTION

Today, the world economy is changing rapidly. In order to retain its place, it always requires active economic growth as well as the efficient production of competitive goods. The economy faces various challenges in its development. These are inflationary processes that occur as a result of price instability and the consequent increase in demand for money in the economy.

The address of the President of the Republic of Uzbekistan, ShavkatMirziyoyev, to the Senate and the Legislative Chamber of the OliyMajlis stated that "one of the principal tasks of the economy in 2020 is to curb inflation, now the emphasis is not given to setting prices, but on reducing prices and improving quality through healthy competition." [3]. Since the rise in prices and inflation in the consumer market is one of the "pain points" not only in our country, but also in the economies of other countries. The effect of reforms in all spheres, the living standards of the people, or being more precisely, the state of the "consumer basket" and the reduction of poverty are also related to inflation.

The current macroeconomic situation, including the current dynamics and forecast indicators of inflation, as well as the need to ensure stable and balanced economic growth, requires the Central Bank to take clearer and more effective measures to ensure the price stability.

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Ensuring the price stability in the economy is one of the fundamental base for improving the living standards of the population and creating a favorable business environment for entrepreneurship. So why is it necessary for country to ensure price stability and curb inflation? The stability of domestic prices in the country will allow the population to maintain the purchasing power of incomes and savings, and create favorable conditions for business representatives to make long-term plans. The low and stable inflation plays an important role in ensuring socio-economic well-being and equality in the country. Particularly the population which demand on socio-economic support, have lower-than-average incomes and are vulnerable to price changes, suffer the most from inflation, as their consumption declines as consumer prices rise. Furthermore, as prices continue to rise, their incomes fall, and their earnings are "swallowed up" by current expenses. The products in this layer of the consumer basket are mainly consist of primary consumer goods, which cannot be replaced by other products "[7].

It is important to note, that the inflation rate is not just a macroeconomic indicator, it is also a mirror that reflects the whole economic situation and processes. Today, with the inflation index of our country at more than 14%, the Central Bank of the Republic of Uzbekistan has a big task to reduce inflation to 5% by 2023 using the targeting regime.

In order to ensure the implementation of the Decree of the President of the Republic of Uzbekistan dated November 18, 2019 PF-5877 "On improving monetary policy through the gradual transition to inflation targeting", the Central Bank will affect the volume of aggregate demand through the use of monetary policy instruments, therefore reducing inflationary pressures in the economy. In addition, the decisions taken by the Central Bank, the work carried out and, accordingly, the communication policy affect inflationary processes as a factor shaping the inflation expectations of the population and businesses.

"The expectation of inflation is an important factor in providing insight into future economic conditions" [4]. Hence, the dynamics of the relationship between inflation and inflation expectations is a process that continues to be studied by central banks. Inflation expectations effect real inflation.

In such situation with the high level of inflation, it is very important to study the views of the Central Bank on its ability to reduce inflation to 5 percent by 2023 and how to achieve this target, as well as to promote it simply so that all segments of the population can understand. We explored the possibilities of accomplishing the tasks set out in this article and formed our own conclusions, basing on the analysis given.

II. LITERATURE REVIEW

In the process of studying the relevant literature on the subject, a natural question arises: how is the inflation target explored and set? What factors are taken into account when setting the inflation target? Why is the inflation target set differently in countries with monetary policy in the inflation targeting regime?

To answer these questions, Czech economists Roman Horvatch and Jakub Matejular analyzed the factors to be taken into account when setting inflation targets in 19 countries that have switched to inflation targeting. They came to the general conclusion that "countries take into account macroeconomic indicators such as past inflation rates, its volatility, GDP growth and external inflation rates when choosing an inflation target".

At this point, the question may arise as to what mode we were in before and why we are moving to an inflation targeting mode now.

Inflation targeting is a contemporary mode of monetary policy, in which every step in the implementation regards as not only monetary policy but the whole macroeconomic policy is based on the impact on inflation and it is mandatory to keep it in low level.

According to local economist D. Murodov, "low and stable inflation is very important for sustainable economic growth of any country" [6]. From this state it is clear that inflation is one of the main criteria determining economic development.

Today, there is a growing interest in using monetary policy analysis. There is a Taylor rule to describe the behavior of the central bank. "According to his researches, the Central Bank should play an active role in ensuring stability in the economy and avoid uncertainties" [5].

The decree of the President of the Republic of Uzbekistan PF-4947 "On the Strategy for further development of the Republic of Uzbekistan" dated February 7, 2017 sets the task "to improve the methodology for monitoring changes in consumer prices (tariffs) for goods and services in determining inflation" [1].

According to U. Mukhtorov, an expert of the State Statistics Committee of the Republic of Uzbekistan, "inflation in our country has been calculated since 1994 with the technical assistance of the IMF. Initially, the list of goods and services was estimated at 285 products, but based on the real needs of a market economy, this list has been expanded to 510 by 2020. It includes not only socially important goods or services such as bread, flour, oil, meat, and utilities that cover basic needs, but also non-socially important products such as automobiles, fuel, jewelry, and agricultural equipment." [7]

According to the Deputy Minister of Finance of the Republic of Uzbekistan A. Haydarov, "products should be divided into two types: monopoly and social goods. The prices of some of them continue to be regulated by the state." [7] It can be concluded that if the government does not intervene in some types of goods and ensure price stability, prices may rise artificially.

III. RESULTS AND DISCUSSIONS

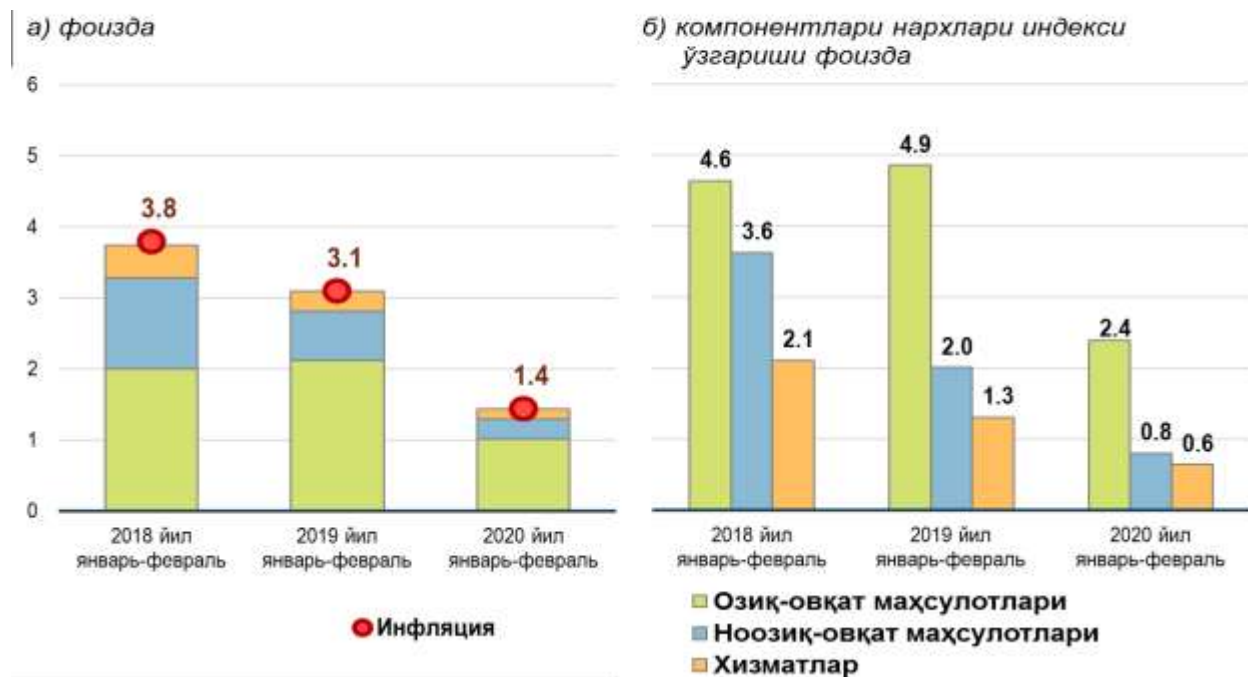
International experience reveals that one of the most effective ways to conduct monetary policy in a market economy is the inflation targeting regime. At the same time, the active participation of the Central Bank in the monetary market, as well as regular analysis of economic development and extensive coverage of public policy plans will ensure the achievement of quantitative inflation targets.

The Central Bank has developed a policy for the transition to inflation targeting for 2020-2023. What can be achieved by switching to targeting mode? Similar questions arise as to how long other countries have switched to the inflation targeting regime and how the Central Bank of the Republic of Uzbekistan differs from the inflation targeting regime, or whether it directly applies the experience of developed countries. In order to clarify it all, we conducted the following scientific research.

Here the question naturally arises as to why this regime has not been switched on before. Because until last year, the legal and practical basis for introduction of such regime had not been created. Now measures have been taken to liberalize the exchange rate policy, to create market conditions for the formation of the exchange rate. The priorities of the Central Bank have been clearly defined, the implementation of monetary policy has entered an active phase, and the methodology for calculating and estimating inflation has been improved.

Given the current macroeconomic situation in the country and ongoing structural reforms, including the liberalization of regulated prices and changes in tax policy, the need to take more drastic measures to curb inflation and the urgency of the transition to inflation targeting, led to the acceleration of the process.

It should be noted that it may not always be possible to achieve the target set by the central banks in a clear and timely manner. In international practice, in certain periods, inflation is often below or above the target. The most important aspect is that the Central Bank explains to the general public the reasons for the deviation from the target and indicates the exact period of return to the target.



Pic. 1: Inflation and Its Main Components in the Last Three Years [8]

An analysis of the data in Pic. 1 shows that in January-February 2018, the inflation rate was 3.8%, while in the corresponding period of 2020 it was 1.4%. The targeting plan pursued by the central bank is proving to be effective.

Today, many developed foreign countries have extensive experience in using different methods of regulating the inflation rate. However, it is no secret that most countries have switched to inflation targeting in order to curb inflation and increase the effectiveness of monetary policy. This regime was originally introduced in 1989 in New Zealand and is now used by more than 30 countries around the world. [6] This regime is useful in successfully reducing inflation and inflation expectations in the short term and improving key macroeconomic indicators.

There are 3 main modes of monetary policy in international practice. They are:

1. Exchange rate targeting;
2. Monetary targeting;
3. Inflation targeting. (There is a fourth, it is called a mixed regime, which is actually called a mixed regime if the central banks do not know what to do or do not follow any regime.)

These regimes differ from each other in terms of monetary policy objectives (operational or intermediate).

If we look at the years when some countries have reached the target of inflation, they are different:

1. The Czech experience covers 1997-2010 (13 years);
2. Polish experience covers 1998-2004 (6 years);
3. The Russian experience covers 2014-2018 (4 years);
4. The Australian experience covers 1993-2018 (25 years);

The Central Bank of the Republic of Uzbekistan is set to cover the period of 4 years, 2020-2023.

Inflation expectations are among the factors that cause inflation. Inflation expectations of the population and business entities in our country are characterized by high levels and constant backward looking inflation. Inflation in Uzbekistan has historically been high, mostly in double digits. As a result, economic agents, based on their experience, expect constant price increases in the future. Given the nature of the population of our country, we can cite many examples. In particular, when the same fruits ripen in the summer, the population's sugar intake increases slightly. As a result, the price of sugar will rise. Our people who have passed this test are encouraged to buy as much sugar as possible. If this situation is not regulated, it can lead to an increase in the price of sugar. The population is accustomed to anticipating this process and expecting an increase in prices, and as a result, an increase in the price level exceeds inflation expectations.



Pic. 2: Inflation Expectations for 2018-2020 [8].

Analyzing the data in Pic. 2, the expected inflation rate by the population and businesses is declining.

However, the fact that inflation expectations are higher than the real inflation rate indicates that inflationary risks will remain.

Table 1: According to the Population, The Factors Influencing Prices in the Next 12 Months [9] (Percentage, Percentage of Respondents who Determined this factor)

	2019m1	2019m2	2019m3	2019m4	2019m5	2019m6	2019m7	2019m8	2019m9
Доллар курсининг ошиши	67	63	57	65	51	56	60	73	73
Иш ҳақи ва нафақаларнинг ошиши	44	43	43	41	52	45	60	55	48
Энергия ресурслари ва коммунал хизматларнинг қимматлашиши	50	50	53	44	36	30	35	40	40
Мавсумий омиллар	19	19	21	19	19	23	20	11	20
Солиқ юкининг оширилиши	41	47	45	40	21	20	22	17	20
Экспорт ҳажмининг ошиши	24	23	24	25	12	16	13	8	11
Аҳолини кредитлаш ҳажмининг ошиши	13	14	17	18	14	16	10	11	13
Транспорт харажатлари ошиши	38	33	34	27	19	13	17	18	23
Айрим товарлар импорти чекланиши	14	12	10	13	11	12	8	8	12
Рақобат муҳитининг ёмонлашиши	9	12	12	14	10	10	9	11	13

An analysis of the data in Table 1 shows that 73% of the participants concluded that the increase in the exchange rate of the US dollar against foreign exchange over the next 12 months is the highest among inflation expectations.

IV. CONCLUSIONS AND SUGGESTIONS

As a result of our research, we can conclude that inflation, inflationary processes, their prevention, elimination of causes and consequences, in sum, are not an instantaneous problem. The implementation of measures set by the head of our state to further reduce inflation will create a basis for improving the living standards of the population and sustainable economic growth, which is one of the key factors in ensuring the effectiveness of economic reforms.

The confidence of the population and entrepreneurs in the banking system will increase if the Central bank will explain in detail what the decision is based on and what goals it pursues, and the effectiveness of its implementation.

Increased transparency of the central bank and the implementation of an active communication policy will increase the confidence of the population and business in the ongoing reforms, inflation expectations will be within the set target.

As a result of the analysis, the following recommendations were developed:

1. Further development of a healthy competitive environment in the country through exploring the international experience, in particular, the opening of access to monopolies for the private sector and thus the formation of a competitive environment;
2. Expand the cultivation of fruits, vegetables, livestock and other food products in order to ensure the stability of food prices in the consumer market, as well as to achieve higher yields using the most efficient methods of productivity;
3. Conducting roundtables in the media with the participation of employees of the Central Bank and economists from leading higher education institutions in order to prevent false inflation expectations among the population.

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