

The Policies That Can Be Implemented To Stop The Value Of UZB Som From Falling

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Abstract – The objective of this paper is to analyze any details about currency devaluation in Uzbekistan. In particular, it tries to analyze possible reasons why the government of Uzbekistan depreciated its national currency Som(UZS) and the goals of the government from devaluating Som. The methodology also offers findings positive and negative impacts caused by the depreciation of Som.

Keywords – UZS (Uzbekistan Som); USD (United States Dollar); depreciation; devaluation of the currency; Two-tier system.

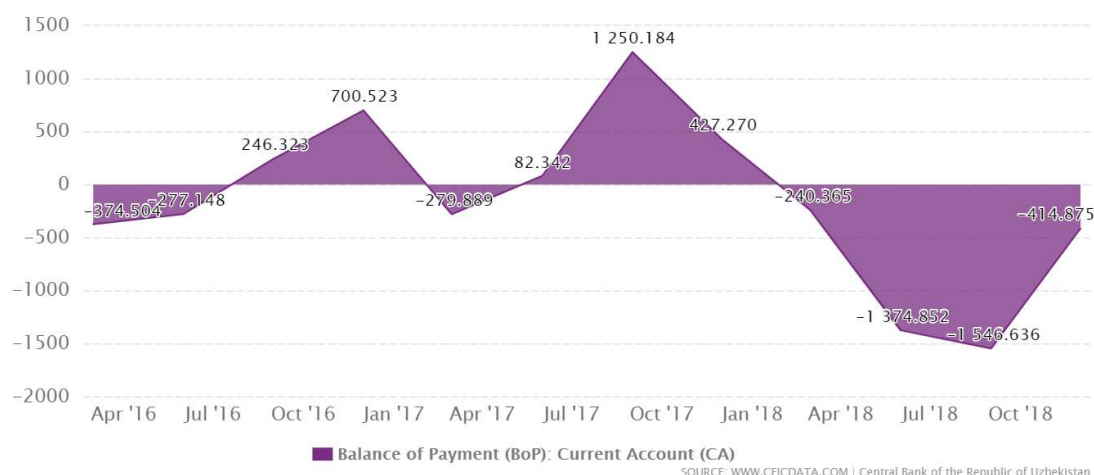
I. INTRODUCTION

Currency depreciation is an important topic which has been drawing the interest of the economists in recent years. The issue has been a topic of numerous international economic and financial researches and studies. This economic phenomenon is defined by the decrease of the value of a country's currency relatively to another currency. When claiming another currency, it is mainly referred to the currencies used as floating exchange rate, in most cases it is US dollar. When occurred, theoretically it can lead to some unlikeable consequences including cheap exports, expensive imports, high rates of inflation. On a more practical matter, currency depreciation causes large trade deficits in the economy and reduces money availability for government spending. Moreover, it may result in very low investment opportunities including low FDI in a country and therefore, slowing down the economic growth and leading to poor living standards. There are several reasons and situations which cause currency rate fluctuations. Therefore, it is an absolute urge to find out and define policies that help stop or at least, slow down the devaluation of the currency. In this essay, specifically, different policies which can be implemented to keep UZB soum from devaluation will be critically analysed and discussed in the context of the current condition of the global economy. All the data used in this paper is taken from World Bank and the official information resources of the government of Uzbekistan.

II. PRIMARY AND SECONDARY FACTORS

To begin with, there are certain factors which determine the appreciation/depreciation of a currency in small open economies. Being first of those factors, inflation rates have an undeniable impact on exchange rates in a country. Keeping inflation rates on low levels provides appreciation in the value of a currency. Therefore, one will see a very small growth rate in prices of goods and services as well as a growing value of a currency in a country with relatively low inflation rates. On the other hand, higher inflation rates exhibit devaluation of a currency leading to high interest rates which is the second determining factor. Interest rates and inflation are very closely correlated to each other. A rise in interest rates makes the country's currency appreciate as it offers

increased rates to lenders, thus attracting high FDI flows. Specifically, when considering the economy of Uzbekistan, inflation and interest rates are said to be secondary determinants of exchange rate as their impact on exchange rates is not as significant as of those factors which will be discussed later on. Study conducted on determinants of exchange rates in Uzbekistan by Jamshid Mamasalaev (2018) showed an insignificant relationship between inflation, interest rates and exchange rates. As Mundell-Fleming model states, higher interest rates equal to higher demand for money. High money demand means that more investment and foreign capital is attracted. As a result, the value of a currency appreciates in currency exchange market. Moving on, country's current account of payments is a significant primary factor influencing exchange rates. This account represents balance of trade and earnings from FDI including all the transactions which consist of exports, imports and remittances. If the account of payment is reflecting a deficit because of country's spending more on importing than earning from exports, country's currency is most likely to depreciate. Conversely, trade surplus is expected to cause an appreciation in the value of a country's currency. Let's look at the Balance of payments account of Uzbekistan for the period from 2016 to 2018:



As it can be seen from the graph, BoP account showed a surplus of 1,250 on October 2017 and the biggest deficit of -1546 on September 2018. Relying on this information, it is reasonable to suppose that exchange rate in Uzbekistan encountered appreciation in 2017 and depreciation in 2018. Furthermore, central bank, in turn, can also affect exchange rate by conducting expansionary monetary policy increasing/decreasing money supply. Increase in the supply of money is supposed to directly lead to the depreciation in the value of the currency. The research conducted on money supply and exchange rate dynamics by Jay H. Levin (1997) concludes that money supply growth has not immediate but eventual tendency to cause devaluation of the currency. The result of this research is confirmed by empirical analysis conducted by Jamshid Mamasalaev (2019) on exchange rate determinants in Uzbekistan stating that one percent increase in money supply causes one percent depreciation of Uzbek som relative to US dollar. From Keynesian model, it is known that the interest rates are determined by money supply and money demand. That is why increasing money supply causes less demand in a currency. As a result, the value of exchange rate currency tends to fall on a market. Therefore, it is reasonable to justify that money supply is one of the primary determinants of exchange rate and should be considered when applying policies to control exchange rates. Another factor which greatly impacts exchange rate fluctuation is government debt. It is a national debt which represents amount of money owned by central government of a country. Any country with big national debt or sometimes referred as public debt, is not likely to attract foreign investment which, in turn, may result in inflation. It is followed by depreciation of the value of exchange rate currency of a country. According to official mass media information source (kun.uz), the government of Uzbekistan has taken measures to attract up to \$ 1 billion in external borrowing from international financial institutions through soft loans and other sources to support the budget in 2020. In this case, one should anticipate depreciation in exchange rate currency due to the expected national debt of the country in the current year.

III. EXOGENOUS FACTORS

All of the above mentioned factors are considered to be endogenous determinants of exchange rate depreciation/appreciation. The impact of exogenous macroeconomic shocks on exchange rates are equally as important. Different unexpected situations and conditions occur on global economy which are out of human control and they have undeniable effect on a country's overall economy

as well, including exchange rates. Let's consider the case of recent pandemics of COVID-19 which started in January 2020 in China. The virus outburst is absolutely unprecedented and exchange rate markets fully reflect its influence on the economy. Every single walk of the economy is impacted by the COVID-19 and its effect can primarily be categorized as following: Demand Shock, Supply Shock and Financial Shock. Outbreak is followed quarantines, border closures, and travel bans which has direct impact on goods and services within a country. Moreover, people stay at home which means they will tend to save money rather than spend or invest. Consequently, a shock is caused in goods market or often referred as Investment-Saving. Moving on, many businesses, factories and enterprises temporarily stop operating because of the situation with the virus. As a result, supply chain is continuously distracted without clear resolving time. Furthermore, roughly all enterprises are threatened by lack of cash flows and liquidity in economic situation where the overall financial condition of a country is under pressure. Shigeru Iwata (2003), in his research conducted on macroeconomic shocks and the foreign exchange risk premiums, concludes that macroeconomic shocks directly influencing output and inflation are responsible for fluctuations in exchange rates. The results are also applicable in Uzbekistan case: because of the closure of many goods manufacturing and service centers, the output in the economy is negatively impacted. Moreover, extraordinary increased demand for the goods of certain industries such as healthcare consumption, food and etc., makes price levels of those goods rise. If this situation is going to continue for longer periods of time, the depreciation in the value of UZB soum is most likely to happen. Uzbekistan is considered to be a small open economy; hence the assumptions of Mundell-Fleming model are applicable in this case. As, economy's interest rate (r) is determined by world interest rate (r^*) plus exogenous risk premium (θ), rise in θ causes shift to the left in IS^* and shift to the right in LM^* . As a result, change in nominal exchange rate is negative which means depreciation in the value of the currency. In order to avoid the devaluation of the currency central bank should decrease money supply moving LM^* to the left. According to official mass media information source of Uzbekistan (kun.uz), the government is going to allocate 200 billion soums to fight unemployment during quarantines due to the COVID-19 outbreak. This basically means increase in government expenditure which is supposed to alleviate the negative impact of the pandemics on the goods market and the overall output. This, in turn, will to some extent prevents the value of the UZB soum from falling.

IV. CONCLUSION AND RECOMMENDATIONS

All in all, under the current circumstances in the global economy, the value the UZB soum most likely will be impacted in one or other way. In the short run, necessary should be taken by the government to stop or at least alleviate the impact of exogenous factors on the value of the currency. As an open small economy, the supply of money should be decreased by the central bank of Uzbekistan so that the change in the value of the exchange rate is positive. Moreover, all the loss suffered by people working in small businesses, educational enterprises, government jobs and all of those who stopped operating because of the quarantine should be compensated by the government to avoid the crisis, at least to some extent. The central bank of Uzbekistan should discreetly control the amount of money being supplied in the economy as it has a direct influence on the value of exchange rates. When it comes to the long run maintenance of the currency value, government should take care of growing the domestic market productivity level as well as much more vivacious participation in international trade. In my point view, these two policies will provide appreciation of the UZB soum and, more stable and healthier economy for the country as well in the long run.

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