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THE ROLE OF MONETARY POLICY IN ENSURING ECONOMIC STABILITY IN DEVELOPING COUNTRIES. THE CASE OF UZBEKISTAN

Azadova Ozoda Murod kizi
University of Exact and Social Sciences
70410102- Field of Economics
2nd year master's student
Email: ozodaazadova55@gmail.com

Abstract. This thesis examines the role and importance of monetary policy in ensuring economic stability in developing countries based on the experience of Uzbekistan. The study highlights the impact of monetary policy on curbing inflation, ensuring national currency stability, stimulating lending and investment activity, and creating favorable macroeconomic conditions for sustainable economic growth. It also analyzes the impact of the Central Bank's key interest rate, inflation targeting mechanism, and monetary policy transmission on the economy. Scientific and practical proposals are developed to improve the balance between ensuring price stability, strengthening financial stability, and supporting economic growth in the Uzbek economy.

Keywords: monetary policy, monetary policy, economic stability, sustainable economic growth, inflation, inflation targeting, Central Bank, key interest rate, monetary policy transmission, macroeconomic stability, investment activity, economy of Uzbekistan.

In today's globalization environment, ensuring economic stability is one of the most important macroeconomic tasks of developing countries. In addition to maintaining high rates of economic growth, curbing inflation, protecting the purchasing power of the national currency, ensuring the stability of financial markets, supporting investment activity, and ensuring the growth of real incomes of the population require effective monetary policy. Especially in developing countries, the rapid growth of domestic demand, high dependence on imports, external economic shocks, exchange rate volatility, and the relative underdevelopment of financial markets pose complex tasks for monetary policy.

Monetary policy is an important component of the state's macroeconomic policy, the main goal of which is to ensure price stability by regulating money and credit conditions in the economy. The Central Bank regulates liquidity in the economy, the cost of loans, and the demand for financial resources through the key interest rate, open market operations, mandatory reserve requirements, and other monetary instruments. In Uzbekistan, the main direction of monetary policy is also aimed at bringing inflation to the target level of 5 percent in the medium term and at the same time creating stable macroeconomic conditions for economic activity. According to the Central Bank, the key rate is the main instrument of monetary policy, which affects interest rates, borrowing, investment, savings and consumption decisions in the economy.

In understanding the mechanism of monetary policy's impact on economic stability, it is important to consider its transmission channels to the economy. An increase in the key rate usually leads to a change in interbank market interest rates, and then in commercial banks' lending and deposit rates. The increase in the cost of loans reduces the demand for loans by enterprises and the population, slows down the growth of consumption and investment demand, and reduces inflationary pressure on aggregate demand. At the same time, high interest rates make savings in the national currency relatively attractive. As a result, an increase in savings and moderation in consumer demand contribute to price stability. The Central Bank itself notes that an increase in the key rate reduces inflationary pressures by reducing the demand for debt and increasing the incentive to save.

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However, monetary policy in developing countries should not be viewed solely as a means of reducing inflation. Because an excessively tight monetary policy can lead to a reduction in credit, a slowdown in investment, and a decline in economic activity. Therefore, the main task for the Central Bank is to ensure price stability while minimizing the negative impact on the economy's production potential. This balance is especially important in a developing economy with high economic growth rates like Uzbekistan.

In recent years, the Uzbek economy has been experiencing high economic growth and a gradual reduction in inflation. According to the International Monetary Fund's 2026 assessment, real GDP growth in Uzbekistan was 6.3 percent in 2023, 6.7 percent in 2024, and 7.7 percent in 2025. During this period, consumer inflation decreased from 9.8 percent at the end of 2024 to 7.3 percent at the end of 2025. The IMF noted the impact of tight monetary policy, the strengthening of the soum, and some supply-side factors in this decrease.

Table 1. Some key macroeconomic indicators of Uzbekistan

Indicator	2023	2024	2025
Real GDP growth, %	6.3	6.7	7.7
End-of-year inflation, %	8.8	9.8	7.3
Credit growth, %	23.2	14.0	15.3
Broad money growth, %	12.2	30.6	36.6
Current account deficit, % of GDP	-7.3	-4.7	-3.9

The table data shows that, despite the high level of economic activity in the Uzbek economy, a downward trend in inflation has formed. The growth of real GDP by 7.7 percent in 2025 indicates that high demand and investment activity in the country's economy are maintained. At the same time, the decrease in inflation from 9.8 percent to 7.3 percent indicates that the tightening of monetary conditions and other macroeconomic factors together reduced price pressures. The IMF notes that growth in the Uzbek economy in 2025 was supported by consumption and investment, with the services and construction sectors among the fastest growing areas.

One of the important aspects of Uzbekistan's monetary policy is the implementation of an inflation targeting regime. The main goal of the Central Bank is to stabilize inflation at a target level of 5 percent in the medium term. To do this, the key interest rate is set in accordance with demand in the economy and inflation expectations. Throughout 2025, the Central Bank maintained the key rate at 14 percent. In particular, on October 24, 2025, the key rate was maintained at 14 percent due to high domestic demand, external supply factors, and high growth in service prices.

By the end of 2025, inflation continued to decline against the backdrop of tight monetary policy. According to the Central Bank, in November 2025, overall inflation was 7.5 percent on an annual basis, and core inflation was 6.3 percent. During this period, high real interest rates supported the growth of savings in the national currency. However, the continuation of high retail lending rates was assessed as one of the factors that could increase inflationary pressures in the future.

At the beginning of 2026, the Central Bank continued to maintain a relatively tight monetary policy. On January 28, 2026, the key rate was maintained at 14 percent. According to the Central Bank, overall inflation decreased from 9.8 percent to 7.3 percent in 2025. Non-food inflation was 5.1 percent, and food inflation was 5.5 percent. The Central Bank noted that tight monetary conditions were one of the important factors in reducing inflation.

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At the same time, new challenges are emerging for Uzbekistan's monetary policy in 2026. Although annual inflation was 5.5 percent in June 2026, core inflation was 5.7 percent. High growth in domestic demand, external economic uncertainties, and some supply-side factors require the Central Bank to carefully manage monetary conditions.

The situation in July 2026 further demonstrates the relevance of monetary policy in ensuring economic stability. The Central Bank maintained the key rate at 14 percent at its meeting on July 29. This decision was prompted by high domestic demand, the secondary impact of changes in energy tariffs, and uncertainties in the external economic environment. In June, headline inflation was 6.4 percent annually, while core inflation was 5.7 percent. The Central Bank stated that it is necessary to continue tight monetary conditions to bring inflation to the target level of 5 percent.

The exchange rate channel is also important in the impact of monetary policy on economic stability. In developing countries, due to the high share of imports, changes in the national exchange rate can quickly affect domestic prices.

A sharp depreciation of the currency can lead to an increase in the prices of imported raw materials, technology, food and consumer goods. On the contrary, the relative stability of the exchange rate helps to reduce imported inflation. According to the IMF, in 2025 the Uzbek soum strengthened by 6.9% against the US dollar, and this factor also contributed to the reduction of inflation.

The credit channel of monetary policy is also of particular importance in the conditions of Uzbekistan. Bank loans are one of the main mechanisms for supplying financial resources to the real sector of the economy. Through loans, enterprises can purchase new equipment, expand production capacity, replenish working capital and create new jobs. Therefore, monetary policy also affects economic activity by affecting the cost of credit. According to the IMF, loans to the economy in Uzbekistan increased by 14% in 2024 and by 15.3% in 2025.

However, excessive credit expansion can also create macroeconomic risks. A sharp increase in consumer demand due to credit can increase inflation in conditions where production and supply capabilities cannot cover demand. Therefore, it is important in monetary policy not only to increase the quantitative growth of lending, but also to direct it to expanding the productive potential of the economy. While investment loans increase production capacity, excessive consumer credit growth can increase pressure on aggregate demand and imports in the short term.

In Uzbekistan, monetary policy must be conducted in coordination with fiscal policy to ensure a balance between economic growth and inflation. A sharp increase in government spending can increase aggregate demand and complicate the task of reducing inflation through monetary policy. Therefore, coordination of monetary and fiscal policies is an important condition for macroeconomic stability. According to the IMF, Uzbekistan's consolidated budget deficit has decreased from 3.0 percent in 2024 to 2.1 percent in 2025.

Another important issue for developing countries is the flexibility of monetary policy to external shocks. Energy prices, food prices, global interest rates, capital flows, and geopolitical uncertainties in the global economy directly or indirectly affect the domestic economy. Changes in energy tariffs in the Uzbek economy were one of the factors that significantly influenced the dynamics of inflation in 2024–2026. An increase in energy tariffs and the liberalization of coal prices played a significant role in the acceleration of inflation to 6.4 percent in June 2026.

In this context, monetary policy should respond appropriately not only to demand-pull inflation, but also to supply-pull shocks. Addressing supply-side inflation by raising interest rates alone can have a negative impact on economic growth. For example, rising energy prices increase production costs. A sharp increase in interest rates can further increase financing costs for businesses. Therefore, in such situations, along with monetary policy tightening, structural policies aimed at improving the

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competitive environment, increasing production efficiency, reducing logistics costs, and expanding supply opportunities should be pursued.

Uzbekistan's performance in 2025 shows that monetary policy can reduce inflation without completely halting economic growth. GDP growth of 7.7 percent and inflation falling to 7.3 percent indicate that price stability can be improved in conditions of high economic activity.

The IMF has projected real GDP growth of 6.8 percent for 2026 and 6.0 percent for 2027; inflation is expected to be 6.8 percent and 5.0 percent, respectively.

Overall, Uzbekistan's experience clearly demonstrates the role of monetary policy in ensuring economic stability in developing countries. Managing the key interest rate in line with inflationary pressures, reducing inflation expectations, encouraging savings in the national currency, balancing lending rates, and ensuring stability in the foreign exchange market are the main directions of macroeconomic stability. In this case, the ultimate effectiveness of monetary policy should be assessed not only by reducing inflation, but also by the quality of economic growth, sustainable growth in investment, employment, and real incomes of the population.

On this basis, in order to further increase the effectiveness of monetary policy in Uzbekistan, it is advisable, firstly, to ensure predictability and transparency of monetary and credit conditions in the process of bringing inflation to the 5 percent target; secondly, to direct credit resources to production and investment projects rather than consumption; thirdly, to strengthen the coordination between monetary and fiscal policies; fourthly, to accelerate the development of the interbank financial market; fifthly, to strengthen the communication policy to reduce inflationary expectations. Also, strengthening competition in the economy, reducing excessive dependence on imports, increasing the efficiency of domestic production and expanding supply opportunities will reduce the burden of monetary policy in reducing inflation.

In conclusion, monetary policy in developing countries is one of the most important macroeconomic mechanisms for ensuring economic stability. In the case of Uzbekistan, a 7.7 percent real GDP growth in 2025, coupled with a decrease in inflation to 7.3 percent, demonstrates the combined impact of monetary policy, exchange rate, and other macroeconomic factors. In 2026, domestic demand, services inflation, energy tariffs, and external economic uncertainties require prudent monetary policy. Therefore, the main condition for long-term economic stability in Uzbekistan is to maintain low and stable inflation, effectively use financial resources, and align monetary policy with the structural development policy of the economy.

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