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PROBLEMS AND SOLUTIONS OF INFLATION TARGETING

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Abstract. The main objectives of the monetary policy of modern Uzbekistan are to ensure the stability of the national currency and reduce inflation. That is why monetary policy, in fact, is a monetary component of the anti-inflationary policy, and the inflation targeting regime has been chosen as a priority direction of the measures implemented by the Bank of Uzbekistan - the establishment of quantitative targets for inflation, the achievement of which in the medium term is an institutional obligation of the monetary authorities. With this in mind, the article discusses the main components of the inflation targeting regime and the stages of its implementation; the types of inflation targeting regimes used in domestic and world practice are analyzed, their advantages and disadvantages are identified, and the possibilities of application by the Bank of Uzbekistan are substantiated.

Key words: inflation, monetary policy, inflation targeting, full-fledged, elective and experimental inflation targeting.

INTRODUCTION

The task of the Central Bank of every country, including the Central Bank of Uzbekistan, is to target inflation. In fact, during the period of devaluation of the soum and transition to free conversion (2017-2019), inflation in the country was at a high level, i.e., around 15 percent on average. But by 2020, the Central Bank managed to reduce the inflation rate to 11 percent. Keeping inflation at a constant low level is the priority task of the Central Bank.

The gradual transition to the inflation targeting regime was approved by the decree of the President of Uzbekistan dated November 18, 2019. According to the decree, the Central Bank ensures that inflation will decrease to 10% in 2021 and to 5% by 2023. According to the International Monetary Fund, the full transition of the Central Bank of Uzbekistan to the inflation targeting system within the approved period has been positively assessed[1].

Experience shows that the central banks successfully perform the function of targeting inflation only when they are independent of the fiscal policy of the state, political and other commercial interests. Inflation targeting as a mandatory norm is the basis of a successful monetary policy.

In the case of inflation, the discretionary policy of the central bank creates "uncertain" expectations among the population about the dynamics of prices in the markets. As a result, we will witness a low level of confidence of the population towards the regulator, and then a speculative high level of inflation. Only the presidential decree on inflation targeting and other such "mandatory norms" will be a guarantee of ensuring the stability of inflation in the future.

However, this does not mean that the Central Bank should completely abandon its discretionary policy. In addition, it is important that the Central Bank balances its monetary and credit policy with economic growth. For example, the European Central Bank, which

[1] https://www.imf.org/en/Countries/UZB

is one of the successful central banks, focuses on targeting inflation, but also takes into account ensuring the stability of economic growth.

As recommended by international experts and the community, the average inflation rate of 2-3 percent for developed countries and 3-5 percent for developing countries does not pose a great threat to macroeconomic stability. However, higher inflation rate has serious economic impact.

LITTERATURE REVIEW AND METHODS.

The best way to mitigate economic shocks due to the predictability of actions of monetary authorities is inflation targeting. Targeting is a fixed amount of an economic variable that the monetary policy of the central bank wants to achieve (Meerza, Syed Imran Ali (2018)).

The question of what is the impact of the inflation targeting (IT) regime on the macroeconomic indicators of the economy was the topic of interest for this study. We took a closer look at the importance of inflation targeting and whether it has had mixed results. Some have argued that IT is important and that it improves economic performance, while others have shown that it has no effect on macroeconomic performance. The question of the impact of IT regimes is still relevant, as 27 countries adopted inflation targeting regimes in 2009 (Hammond, 2012).

Inflation targeting has become more flexible because all IT regimes using central banks not only aim to stabilize inflation around the inflation target, but they also want to stabilize the real economy. This makes IT regimes appear too rigid, when in fact they are more flexible (Svensson, 2010).

Critics of inflation targeting have noted seven major flaws in this monetary policy strategy. Four of these disadvantages are that inflation targeting is too rigid, allowing for too much discretion. That it has the potential to increase output volatility, which reduces economic growth, is discussed in Mishkin (2011) and Bernanke (2011).

Consistent with Bean (2003), Tucker (2006) argues that monetary policy should pursue the objective of price stabilization. At the same time, it recognizes the need to further examine how asset prices and risk premiums affect the real economy and integrate this into central banks' macroeconomic forecasting models. Assenmacher-Wesche and Gerlach (2008) study property prices and monetary policy in 18 OECD countries. They find it difficult to control the increase in real estate prices by tightening monetary policy because it affects economic growth.

ANALYSIS AND RESULTS

The best way to mitigate economic shocks due to the predictability of actions of monetary authorities is inflation targeting. Targeting is a fixed amount of an economic variable that the monetary policy of the central bank wants to achieve.

Here are four main interrelated problems caused by inflation:

The first problem is the decline in the purchasing power of the currency. Consequently, such an "inflationary tax" forces people to abandon holding assets in this currency, and this trend has negative consequences in the long run.

The second problem is the "inflationary surprise" of the population and business, which causes an unexpected difference in the purchasing power of certain parties. The consequences of such a surprise can be two-fold: good for debtors, and the opposite for creditors.

The third problem is that frequent changes in inflation can create a kind of "uncertainty" among economic agents (business, population, etc.). On the contrary, it may complicate the economic planning of the parties and create a speculative environment in

the future. Consequently, such chaotic (disordered) economic behavior harms both parties.

The fourth problem is related to the uneven origin of inflation. In general, inflation is an average of price increases. That is, individual prices can rise to different levels.

This, in turn, creates two problems:

1) this formation of price changes may not adequately reflect the relative scarcity of goods and services and thus give wrong signals to sellers and buyers;

2) this formation of price changes makes it difficult to predict inflation and economic planning among economic agents.

Depending on which economic indicator is chosen as the goal of the monetary policy, target regimes are distinguished, each of which includes a certain set of tools to achieve the goal. The types of targeting modes are as follows:

Inflation targeting. In inflation targeting, the country's central bank (regulatory body) sets a specific target or an acceptable range of inflation. In case of deviation from the target level, measures are applied by the state. Inflation targeting differs from country to country. Although there is no clear concept of optimal inflation in the economy, historical data shows that developed countries often set an inflation target range of 2% and emerging market countries - 3% and above. Inflation targeting has a positive effect on the economy if it is forecasted on the basis of accurate and reliable data and is long-term. As a result, all participants of the economy will have information about what can be expected from the state policy in terms of economic development. The ultimate goal of inflation targeting is price stability. In the context of inflation targeting, the main tools of monetary policy are the key rate and the link.

Monetary targeting. Targeting of the money supply means that the central bank sets goals for the growth of the total money supply and, in particular, money aggregates. By managing monetary aggregates, the central bank affects the main macroeconomic indicators (inflation, unemployment and economic growth). Monetary targeting was used in several countries in the 1970s and 1980s, but was not effective enough because of the low usefulness of information on the state of monetary aggregates to the general public. Currently, the dynamics of monetary aggregates is often used by regulators as analytical information along with other macroeconomic data.

In addition to the new monetary policy launched in Uzbekistan, it is appropriate to make recommendations from the point of view of forming the prospects of the population and business.

First of all, it is necessary for the Central Bank to continuously provide the inflation targeting system. The formation of short-term and long-term expectations among the population and businesses is directly related to compliance with the inflation target discipline of the Central Bank.

Secondly, price stability cannot be ensured by monetary policy alone. It is also necessary to conduct an appropriate fiscal policy. International organizations and experts recommend that developing countries, especially countries undergoing large-scale reforms and fundamental changes, keep the budget deficit at a moderate level. Why, a sharp increase in the fiscal deficit causes an "inflationary surprise" of economic agents, which, in turn, leads to a rise in inflationary expectations, as mentioned above.

Exchange rate targeting involves fixing the exchange rate within a certain range by linking the nominal or real value of the national currency to the value of a commodity, usually gold or other stable currencies. Keeping the exchange rate in the target range requires continuous active actions from the regulator, such as foreign exchange interventions, accelerating or slowing down the depreciation of the national currency. A serious disadvantage of currency targeting can be the complete displacement of the

national currency, as well as the dependence of the economy of the host country on the economy of another country whose currency is chosen as an anchor. Officially, several countries conducted monetary policy in the regime of targeting the exchange rate: Brazil, Colombia, Yugoslavia, Chile and Tunisia. In the first three, this led to high inflation. The ultimate goal of exchange rate targeting is currency stability.

Nominal GDP targeting. The Central Bank sets a target for a certain value of nominal GDP and uses the means of economic growth. For example, when economic growth slows, the central bank allows more inflation to stimulate economic growth. Conversely, when the economy becomes too fast due to too fast economic growth, the regulator tries to slow down inflation. Nominal GDP targeting is considered by economists to be an effective policy in preventing supply shocks. The ultimate goal of GDP targeting is balanced economic growth.

In addition to the above, other indicators such as unemployment or national income may be possible targets of central bank policy.

Targeting is used to achieve the ultimate goal of monetary policy. By targeting, the central bank tries to achieve stability: prices; economic growth; high level of employment; interest rates; financial markets; exchange rate.

In general, despite the fact that any target regime strives for prosperity in the country, one of them is chosen due to rationality - achieving several indicators at the same time requires the regulator to distribute efforts, and this can also be difficult. implementation due to conflicting goals. The main advantage of targeting is the possibility of consistent policy implementation, its predictability by economic actors. Determining targeting directions consists of the following interrelated steps (fig.1).

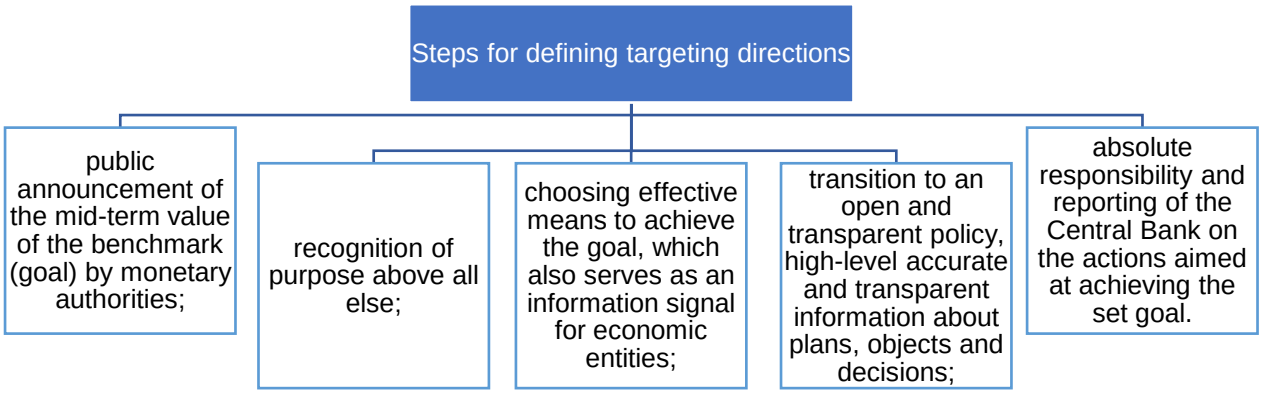


Figure 1. Description of the steps involved in setting the targeting directions

Source: Compiled by the author based on.

In the case of inflation, targeting is a certain level or range of price growth. The deadline for achieving the goal is usually set for a calendar year. Choosing an operational goal, which is also determined in a certain period of time, and the quantitative value of the goal is appropriate. The operational objective of the Bank's monetary policy is to keep interbank money market rates close to the key rate. It consists in the correct selection and application of monetary policy tools to achieve the operational goal. The main tool for measuring inflation is the interest rate. By setting the base rate in international practice, the bank keeps money market rates within the range of interest rates (+/-1 percentage point of the base rate). It is mainly carried out through auctions to ensure liquidity (repo auctions) or auctions to obtain liquidity (deposit auctions).

The change of the main rate and then the rates on interbank loans leads to the mutual adjustment of rates in other segments of the financial market (bonds, deposits, loan rates) and, as a result, all interest rates. We believe that it is appropriate to analyze the results of the measures taken, their effectiveness in terms of achieving the target level of inflation, and to announce the forecast trajectory of the main rate. In the table below, we will analyze the positive and negative aspects of targeting on the example of the inflation regime.

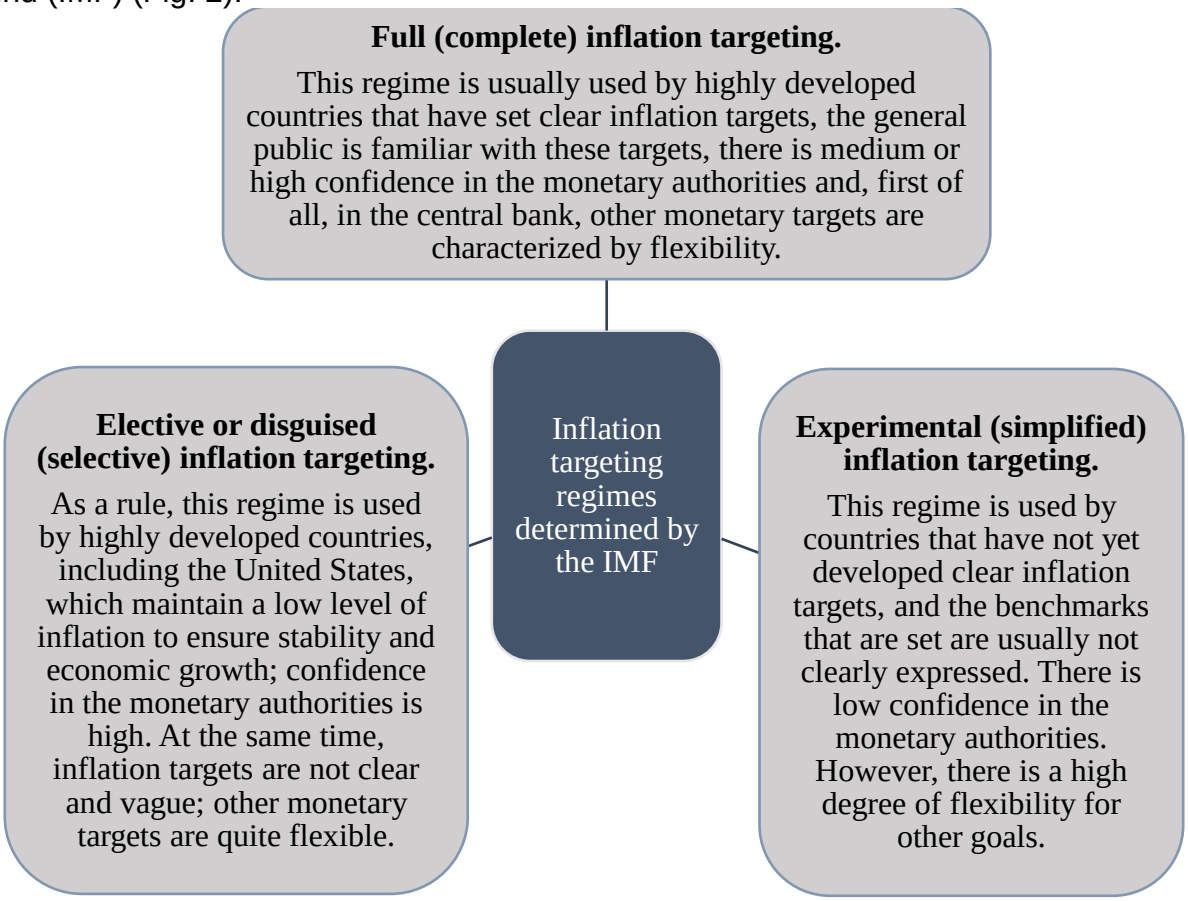
Table 1. SWOT analysis of inflation targeting

Strength	Weakness
– the transparency of the monetary policy and, as a result, the availability of its forecasting; – if all economic participants clearly understand what and how the regulator wants to do, they can set personal financial goals; – investors' uncertainty also decreases - they can predict changes in interest rates and inflation expectations and, on this basis, assess the profitability of investments in the country's economy; – The Central Bank can effectively respond to shocks in the economy through monetary policy instruments; – well-targeted transparent monetary policy leads markets to self-regulate during shocks without central bank intervention; – keeps inflation at a relatively low level; – assumes smaller losses to the economy if the chosen direction of monetary policy turns out to be unsuccessful; – proved its effectiveness in raw material exporting countries; – the application of the inflation treatment regime is understandable to the public; – increasing the responsibility of the Central Bank for its actions; – increases the confidence of economic agents in the policy pursued by the Central Bank.	– against the backdrop of inflation, the possibility of speculative bubbles and other shocks in the economy caused by the regulator; – possible inadequate response to trade conditions or supply shocks; – possibility of currency depreciation due to high inflation; – difficult management in periods of high volatility, as it often increases the volatility of the exchange rate and leads to market instability; - the dynamics of inflation (in countries with economies in transition) depends on many factors that are not sufficiently controlled by the monetary authorities; - inflation targeting does not work in countries where there is no or weak confidence in the monetary authorities, the technical and institutional infrastructure is not developed; - greater concentration of monetary authorities on achieving the inflation target may lead to ignoring other macroeconomic indicators. In the short run, inflation targeting leads to slow and erratic output of goods, and in the long run to large fluctuations in employment and GDP;
Opportunity	**Threats**
– The Central Bank can focus its attention on price stability, that is, a gradual shock-free decline and consolidation at an acceptable level of inflation; - the monetary authorities can focus on the internal problems of the economy, as the inflation targeting allows for a more flexible response to changes in the macroeconomic situation.	The inflation targeting trap: - the inflation targeting regime is aimed at tightening the conditions for the growth of the money supply in the country, which means that it can lead to an artificial restraint of economic growth; - an attempt to contain inflation by non-market methods leads to a slowdown in economic growth, while, in fact, monetary regulation, on the contrary, should stimulate economic growth.

Source: prepared by the author

The content and duration of the implementation of the tasks of each of the considered stages depends on the level (type of regime) of inflation targeting. It should

be noted that currently there is no single approach to the classification of inflation targeting levels. The most common and most frequently used by experts of the Central Bank of various countries is the classification proposed by the International Monetary Fund (IMF) (Fig. 2).



Picture 2. Inflation targeting regimes determined by the IMF

Source: Compiled by the author based on.

In this case, the main criteria that make it possible to distinguish between inflation targeting regimes are: “the degree of confidence in the national banking system; transparency of monetary policy; stability of macroeconomic parameters; the development of financial institutions and the stability of political institutions; flexibility in the response of the financial and monetary system to changes in monetary policy instruments”.

We identify several different types of inflation targeting regimes - initial, classical and higher. For countries with a stable economy and well-functioning monetary institutions, as well as the availability of “fine-tuning” tools (such as Japan, the USA, Switzerland, Singapore), the highest inflation targeting regime is typical; for many countries of Central Europe, South African countries and Peru - classic; for emerging market countries undergoing major institutional transformations (such as countries of Eastern Europe, Slovakia, Uruguay, and Russia), the initial (lower) targeting regime.

We see that the inflation targeting regime is very controversial, has a number of shortcomings, which require time and resources to eliminate. In addition, the introduction of an inflation targeting regime requires compliance with a number of conditions that allow it to be carried out effectively. An assessment of the fulfillment of these conditions

revealed the failure to fulfill three basic ones - the institutional independence of the Central Bank, an effective structure of the economy, and a developed financial system.

CONCLUSION

Despite the fact that the inflation targeting regime places high demands on the institutional, financial and macroeconomic environment, “recently, after the positive results achieved by countries that have switched to inflation targeting became apparent, this view has begun to change”

Uzbekistan has not yet formed the whole range of conditions necessary for the introduction of a full-fledged inflation targeting regime, because:

1. Sufficient experience of economic development in the conditions of stable low inflation rates has not yet been accumulated. The experience of economically developed countries has shown that inflation targeting is designed for the long term and is based on a long-term experience of low inflation.

2. In practice, inflation is a complex process, which is based on both monetary and non-monetary factors. In this situation, monetary policy measures do not affect the economy immediately, but with a significant delay, that is, the policy is characterized by a rather long regulation lag. In Uzbekistan, as a rule, inflationary factors are of a short-term nature, so monetary policy is not able to fully resist them. In addition, the Bank of Uzbekistan cannot exercise full control over all components of inflation due to its predominantly non-monetary nature.

When targeting inflation, forecasts play a decisive role, the reliability of which determines the correctness of decision-making in the field of monetary policy. In the Republic of Uzbekistan, inflation expectations often change depending on unpredictable political events inside and outside the country, therefore, the reliability of forecasts is violated, they cannot be considered as a basis for decision-making by the Bank of Uzbekistan.

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