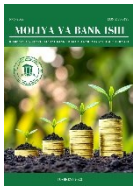
MOLIYA VA BANK ISHI
O‘ZBEKISTON RESPUBLIKASI BANK-MOLIYA AKADEMIYASI ILMIY JURNALI



THE ROLE OF THE CENTRAL BANK OF THE REPUBLIC OF UZBEKISTAN IN PLACEMENT OF GOVERNMENT SECURITIES

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Abstract

This article examines the role that the central bank can play in supporting and developing debt markets and how central bank policy could complement, or interfere with, government fiscal operations and debt management. It briefly reviews developments in Uzbekistan bond market and then focuses on three aspects of the central banks' role in sovereign debt management: (i) as the manager of government debt; (ii) as an issuer of debt; and (iii) as the promoter of debt markets.

Introduction

Domestic bond markets underpin the economy and the financial system in several ways. Sovereign bonds set the benchmark yield curve, and provide high-quality collateral for financial transactions. Indeed, deeper domestic bond markets in many emerging market economies, including in Uzbekistan, tend to be associated with more efficient and stable financial systems. The domestic bond market is critical to the economy and the financial system for many reasons. First, sovereign debt issued by either the central bank or the central government plays a major role in the development of a credit market. It is generally safer than debt instruments issued by private parties. Second, the yield on sovereign debt serves as the baseline from which all other debt instruments in the same market can be priced by adding appropriate risk, liquidity and term premiums to the underlying pure interest rate. Third, high-quality securities aid market development by providing quality collateral to secure financial transactions. Finally, a well-developed domestic bond market helps the government to finance its fiscal deficit in a non-inflationary way. Central banks have a natural interest in developing bond markets. Yet the crisp distinction between debt management and monetary policy in economics theory is far less sharp in the actual practice of government fiscal operations.

Debt issuance by the government can constrain the options and outcomes of monetary policy. Similarly, debt issued by the central bank for monetary policy purposes can impact the market for government debt. It can also have implications for financial stability. Government decisions about the currency denomination and the maturity of the government's own debt have had a major impact on the development of local currency debt markets. Such debt issuance strategies were in the past opportunistic, paying scant attention to the possible implications for financial stability (or to the medium-term fiscal consequences). But in recent years, governments have taken a more principles-based approach to the management of debt. This involved avoiding issuance policies that undermined macroeconomic control. A more deliberate focus on balance sheets was developed, leading to efforts to quantify risk exposures.

Literature review

Central banks have a key role in developing local debt markets. The development of local currency bond markets is critical to country's financial development and resilience to shocks. Government fiscal and debt management policies should not undermine effective monetary policy. Good macroeconomic policy requires mechanisms that ensure appropriate coordination but avoid potential conflicts of interest. Domestic bond markets underpin the economy and the financial system in several ways. Sovereign bonds set the benchmark yield curve, and provide high-quality collateral for financial transactions. Indeed, deeper domestic bond markets in many emerging market economies tend to be associated with more efficient and stable financial systems. [1]

Financial stability frameworks need to be

strengthened. Central banks must have a major voice in financial stability policy which is closely linked with monetary policy. Central banks are naturally the official institution closest to financial markets. Nevertheless, responsibility for financial stability will almost always be shared with other bodies. How this is done will differ from country to country. But, however done, supervisors need the independence and the powers to act quickly and impartially. [2]

Among the most important players in financial markets throughout the world are central banks, the government authorities in charge of monetary policy. Central banks' actions affect interest rates, the amount of credit, and the money supply, all of which have direct impacts not only on financial markets but also on aggregate output and inflation. [3]

The central bank has a role in a market-driven financial system. While there are different views on what that role should be, some essential elements are not in dispute. The primary role of a central bank is to provide an immutable guarantee of the long-term stability of the purchasing power of money. By providing price stability, the central bank can increase the efficiency and stability of financial markets. Second, the central bank can provide financial stability through open-market operations and a properly functioning discount window that prevents irrational bank runs from becoming systemic runs. Third, the central bank can encourage and supervise competition in financial markets and the development of private payment arrangements. [4]

Analysis and results

The smooth operation of debt markets is critical to monetary policy. The central bank is often the fiscal agent and so helps to ensure that markets function effectively. The relationship between government and central bank is often spelt out in a fiscal agency agreement. As agent, the central bank acts on the instructions of the principal and, accordingly, it should have no independent authority over sovereign debt management. By contrast, when central banks act as debt managers, they are more directly involved in the decisions regarding the cost and the maturity structure of government debt.

The maturity of long-term government bonds is the domain of debt management. But decisions about treasury bill issuance are part of debt management and part of monetary policy. Historically, the monetary authorities have often expressed their concerns about the impact of the sovereign issuance of very short treasury bills (T-notes) on the stance of monetary policy. Until the mid-1990s, for instance, the Deutsche Bundesbank took the view that the government should finance itself with medium- and long-term securities only. One compromise solution to potential policy conflicts about this is not only to coordinate the timing and to exchange information on new issuance, but in addition to agree on an issuance ceiling for bills. The shorter the maturity of treasury bills, the closer they are to "money". More generally, the structure of public debt (e.g. maturity, currency of denomination) and its holders (e.g. banks, institutional investors, non-residents) will affect the transmission mechanism of monetary policy.

Central banks are assigned the goal of macroeconomic stabilization, while debt managers are typically mandated to keep governments' funding costs to the minimum. Government debt managers evaluate the trade-offs and risks of different ways of financing government borrowing. Although sovereign debt management deals primarily with fiscal policy actions, it has implications for monetary policy. For example, considering a simple accounting identity of the government budget that governs fiscal balance. Defining terms as follows (time is indicated by the subscript t):

Dt = budget deficit

Bt = stock of government bonds (i.e. paper with a maturity greater than one year)

TBt = stock of treasury bills (with a maturity of less than one year)

Mt = base money

The simplest representation of the financing of the government is given in Figure 1. Monetary policy refers to the determination of demand debt.

Fiscal policy		Debt management		Debt management or monetary policy?		Monetary policy
D_t	=	$[B_t - B_{t-1}]$	+	$[TB_t - TB_{t-1}]$	+	$[M_t - M_{t-1}]$

Figure 1. The government budget constraint and links between fiscal policy, debt management and monetary policy.

One implication of the maturity structure of debt is that it has a significant effect on the term premiums, and hence the shape and the slope of the yield curve. Excess demand for long-term securities (relative to supply) can reduce term premiums, leading to a flatter yield curve; conversely, an excess supply may increase term premiums, steepening the yield curve. Thus, monetary conditions – hence aggregated demand – can change, without changes in the policy rate.

Another implication of debt maturity relates to its effect on bank credit. In the conventional monetary transmission mechanism, bank credit is determined primarily by demand forces, so that issuance of short-term debt or bank reserves should play little role in the determination of credit. In this case, when banks increase their holding of government bonds, they may crowd out credit to the

private sector. Under imperfect market conditions, however, debt maturity can affect banks' lending behavior. There are two major channels through which this may occur. One is that banks may face financing constraints. Short-term government and central bank bills could then act as liquidity buffers (bank reserves in waiting), relaxing these constraints and enhancing banks' capacity to lend. Another is that liquid assets provide an easy way for investors to leverage up their balance sheets. Banks and other investors may use their bond holdings to build riskier exposures.

Coordination between debt managers and monetary authority is essential, not just for the smooth operation of various monetary transmission mechanisms but also for monetary and financial system stability. One aspect of this coordination relates to the portfolio of public debt, which must be sustainable. The timing and size of debt and scheduled repayments must not overwhelm the public budget. For this reason, debt managers are expected to prepare a medium-term debt management strategy with explicit assessments of economic stresses likely to impact the cost or subsequent marketability of the debt portfolio. By sharing its assessment about probable exogenous factors and endogenous developments as well as the associated risks, the central bank can help the central government develop a debt strategy.

Public debt should be structured in ways that do not magnify the macroeconomic or financial consequences of market shocks. Such shocks could include:

- ✓ a sudden drop in the exchange rate;
- ✓ a sharp rise in domestic short-term interest rates;
- ✓ a temporary loss of market access.

This means limiting reliance on foreign-currency debt, even if this carries a lower coupon. It also means avoiding heavy reliance on short-term debt. Allowing too much debt to mature at any one time may provoke market dislocations through the market's inability to absorb or buy sufficient debt to pay off the maturing issues.

A second aspect of coordination relates to management of government cash balances. This is required to avoid conflicts between debt or cash management by the treasury and the open market operations of the central bank. The government has the key information in its cash forecast, and it should be expected to share such data with the central bank. The key revenue and expenditure transactions are those that shift funds between the government's accounts at the central bank and accounts at commercial banks and alter the government's net position at the central bank. A shared forecast may be useful in assisting the central bank in planning monetary policy action; detailed cash forecasts are important also for the government's purposes. Building the network of information flows to consolidate the disparate data sources can support better cash management and highlight inefficiencies in the current system. Further, an effective cash management program can be expected to take actions to maintain cash balances within a targeted range. The effect of these cash management operations – assuming the government's funds are kept at the central bank – may tend to neutralize the effect of these receipt and expenditure flows on banking reserves. During periods of surplus, when funds are drawn in from the economy, the cash manager may place balances in bank accounts to earn interest on excess balances and add reserves to the banking sector. During spells of cash stringency, with large expenditure flows out to the economy, the ministry of finance might issue treasury bills or take other forms of short-term credit that would drain reserves from the banking system. These actions are similar to the choices that would be made by the central bank in its open market operations. Financing and cash management actions by the ministry of finance can thus be seen as liquidity shocks that the central bank must address.

Complications might arise if the government's cash management operations are conducted with the same market participants and with instruments comparable to those of the central bank. Careful coordination will be required between the ministry of finance and the central bank. Such coordination may actually curtail the central bank's use of its own bills, particularly if both managers are using similar maturities. Each party should keep the other well informed of its own actions and seek cooperative solutions whenever policies appear to conflict.

A final aspect of coordination requires reducing the adverse monetary effect of debt issuance, particularly short-term debt. An annual budget law will give an early forecast of how much additional government debt can be expected in the market over the coming year, but it will generally lack specificity as to timing and the actual maturities that will be issued. The financing activities of the government will alter bank reserves, interest rates and the marketability of other securities. The central bank will need to maintain effective liaison and coordination with the government throughout the budget cycle.

Issuance of government securities in accordance with the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No. 1016 "On measures to organize the issuance of state treasury obligations and bonds of the Republic of Uzbekistan" on behalf of the Ministry of Finance of the Republic of Uzbekistan and at the expense of the Central Bank of the Republic of Uzbekistan (fiscal agent) will be placed and extinguished through the trading platform of "Republican Currency Exchange of Uzbekistan" JSC. Government securities (except bonds of the Central Bank) can be placed between residents and non-residents of the Republic of Uzbekistan. Annual amounts of government securities placed among non-residents are determined by the Ministry of Finance in agreement with the Central Bank.

Government securities are issued in the form of short-term (up to one year) treasury bonds of the Republic of Uzbekistan, as well as medium-term (from one to five years) and long-term (up to five years) issued in the form of treasury bonds of the Republic of Uzbekistan) and can be placed between legal entities and individuals who are residents and non-residents of the Republic of Uzbekistan.

The Central Bank has the following rights while performing the function of fiscal agent:

a) Placement and circulation of government securities, the procedure for maintaining rights to government securities and the correctness of accounting, control over the implementation of REPO transactions, as well as requirements for the trading system of the

currency exchange of the Republic of Uzbekistan designation;

b) Establishing requirements for dealers in transactions with government securities and concluding agreements on the performance of dealer functions;

c) Conducting an auction based on the order of the Ministry of Finance on the primary placement of government securities, as well as setting requirements for the rules of its transfer;

d) Implementation of additional primary placement of in circulation based on the order of the Ministry of Finance;

e) According to the order of the Ministry of Finance, the issuing of Government securities and interest payments at the expense of the funds of the republican budget of the Republic of Uzbekistan;

f) Suspending the operations of any dealers on government securities in case of violation of the provisions of this Regulation and the exchange trading rules of the Currency Exchange of the Republic of Uzbekistan;

g) Carrying out operations on the secondary market.

The full range of monetary policy tools can be deployed only if there is an active, liquid and deep secondary market. An active secondary market, in turn, depends on many factors, including a well-developed primary market, a diversified investor base and a modern market infrastructure. In addition, adherence to market-determined interest rates is essential. However, it is common practice in many developing countries to severely restrict price determination in government securities markets by constructing barriers to entry (e.g. foreigners), imposing mandatory investment requirements on domestic financial institutions or rejecting bids which diverge from a predetermined interest rate range.

It should be noted that starting from October 5, 2022, the mobile application "UZCE mobile GB" developed by the Currency Exchange of the Republic of Uzbekistan was launched in this market, and through this software, it was possible to remotely carry out transactions with government securities. In addition to conducting remote trades, the users of the application had the opportunity to get acquainted with various information, including the news of the government securities market, as well as to further activate and improve the trading processes in the government securities market.

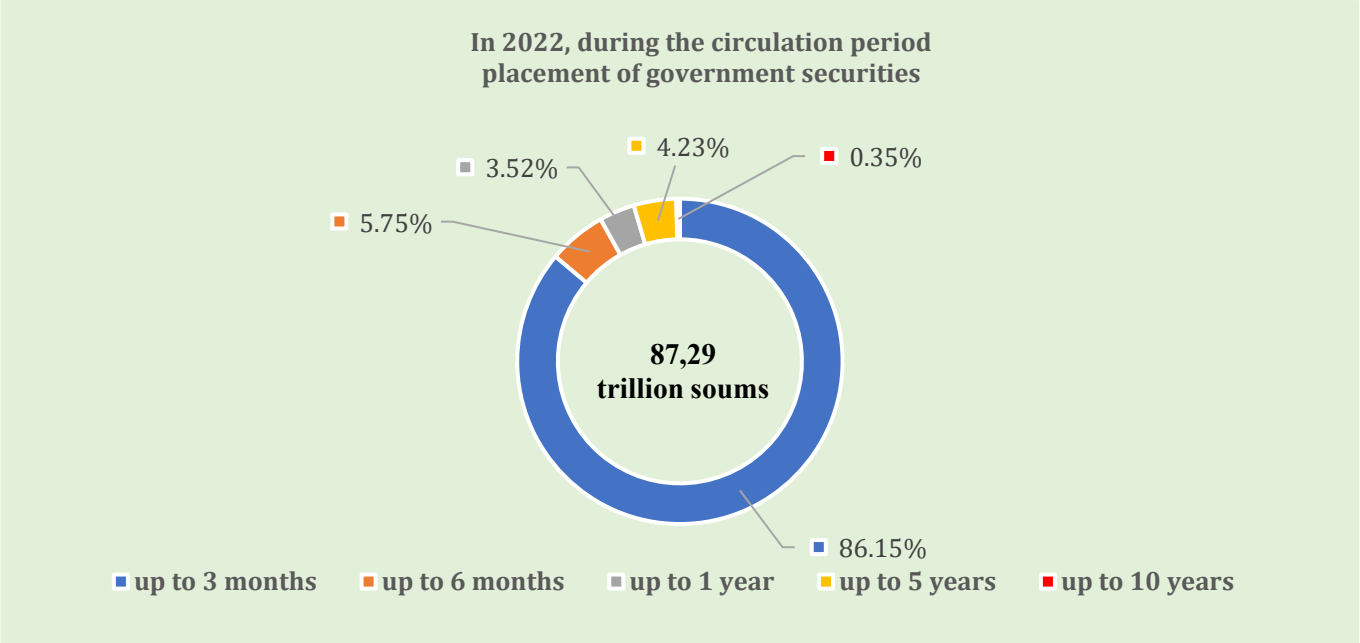

Figure 2. In 2022, during the circulation period placement of government securities.[1]

During the auction, 149.7 billion soums government securities with a circulation period of 5 years. was placed in the amount of soums, and the weighted average yield was 18.08% per annum. In general, during the reporting period, securities worth 87.29 trillion soums were placed on the government securities market, which was 3.5 times more than the figure of 2021 (24.85 trillion soums).

On November 1, 2022, for the first time in the auctions of the Currency Exchange of the Republic of Uzbekistan, the European Bank for Reconstruction and Development, as a foreign investor, concluded agreements on the purchase of government securities through "ASAKA BANK" JSC. During the II international economic forum held in Samarkand on November 3-4, 2022, the Ministry of Finance of the Republic of Uzbekistan, the Central Bank and 9 commercial banks signed agreements on the performance of primary dealer duties in the market of government securities on November 29, 2022, the Currency Exchange of the Republic of Uzbekistan The first auction for the placement of government securities among primary dealers was held on the platform.

The number of government securities placed at the auction was 560,000 units. In addition, on December 20, 2022, for the first time on the trading platform of the Currency Exchange of the Republic of Uzbekistan, government securities were placed by the Ministry of

[1] Source. Prepared by the author based on the information of the Currency Exchange of the Republic of Uzbekistan.

Finance for targeted financing of infrastructure development.

Table 1. In 2022, the volume of government securities placed by the Ministry of Finance during the period of circulation.[2]

In 2022, the volume of government securities placed by the Ministry of Finance during the period of circulation		
Circulation period	**Sales volume,** *billion soums*	**Shares in percentage**
up to 1 year	8 572,85	68,18%
2 years	2 018,72	16,06%
3 years	768,05	6,11%
5 years	907,4	7,22%
10 years	306,71	2,44%
Overall	**12 573,73**	**100,00%**

As you can see from the data in this Table 1, during 2022, 81 auctions of the Ministry of Finance for the placement of government securities were held, and the total volume of government securities placed in them was 12.57 trillion. amounted to soum. By the end of 2022, more than 68% of the government securities placed by the Ministry of Finance corresponded to short-term treasury obligations with a maturity of up to one year.

The proceeds from the placement of government securities will be transferred to the State budget of the Republic of Uzbekistan and measures aimed at covering the deficit of the State budget of the Republic of Uzbekistan and socio-economic development of the country, as well as within the approved parameters of State budget expenditures of the Republic of Uzbekistan. It is directed to the implementation of large investment projects determined by the decisions of the President of the Republic of Uzbekistan.

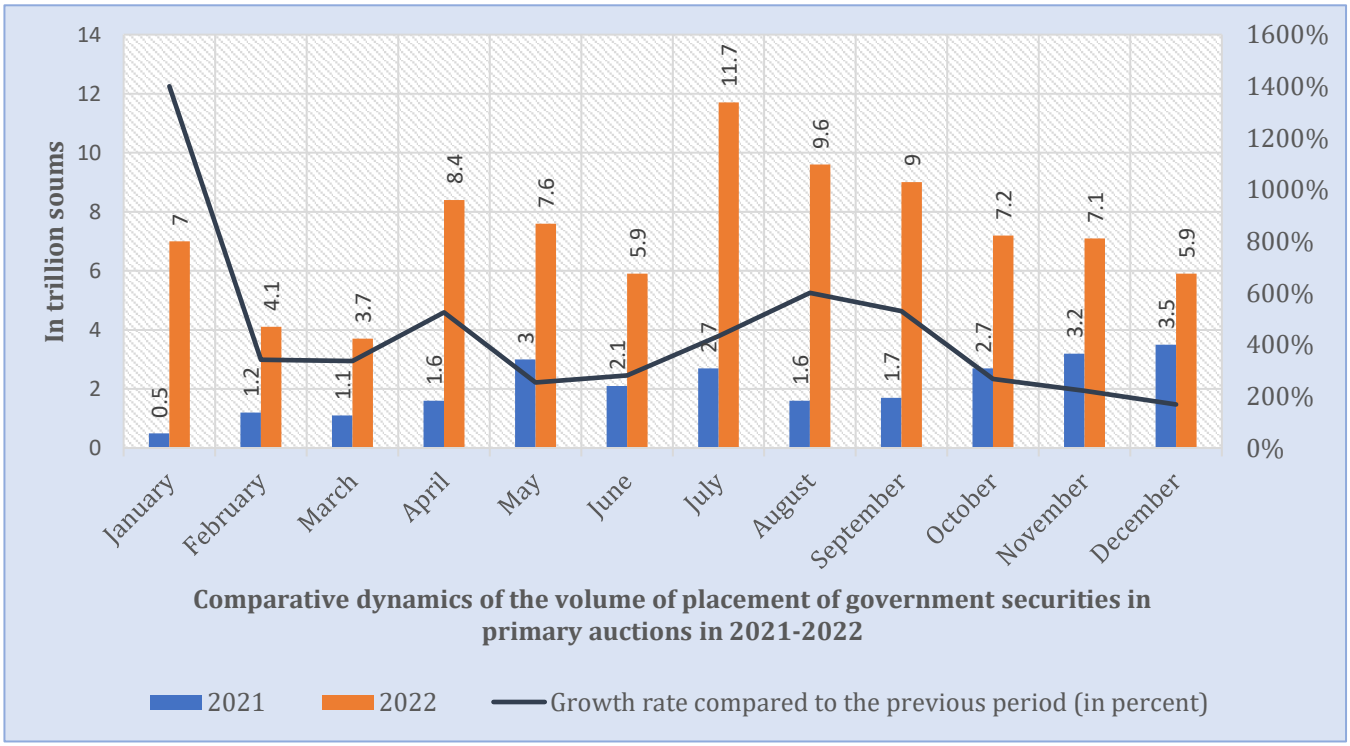

Figure 2. Comparative dynamics of the volume of placement of government securities in primary auctions in 2021-2022.[3]

In this figure, we can see that in January 2022, the volume of placement of government securities was 7 trillion soums, and this value was 14 times more than in the same period of the previous year. Also, in July 2022, compared to the entire period, the largest volume of government securities was placed, which amounted to 11.7 trillion soums. From this figure, we can conclude that the demand for government securities is increasing year by year, which in turn leads to further development of the government securities market.

[2] Source. Prepared by the author based on the information of the Currency Exchange of the Republic of Uzbekistan.

[3] Source. Prepared by the author based on the information of the Currency Exchange of the Republic of Uzbekistan.

Table 2. In 2021-2022, the volume of government securities in circulation recorded in the depository of the Currency Exchange of the Republic of Uzbekistan.[4]

In 2021-2022, the volume of government securities in circulation recorded in the depository of the Currency Exchange of the Republic of Uzbekistan			
			billion soums
Circulation period	**As of December 31, 2021**	**As of December 31, 2021**	**Changes in percentage**
up to 3 months	5 500,00	14 700,00	167,27%
From 3 to 6 months	8 121,00	4 303,38	-47,01%
6 months to 1 year	1 579,66	3 592,30	127,41%
1 to 5 years	1 640,79	4 832,22	194,51%
5 to 10 years	-	310,00	-
Total	**16 841,45**	**27 737,90**	**64,70%**

As you can see from the data in this Table 2, as of December 31, 2022, the volume of government securities kept at nominal value in the account registers of the Foreign Exchange Depository of the Republic of Uzbekistan has increased by almost 64.70% compared to the previous year and is 27,737.90 billion. amounted to soum. Also, the share of securities with a maturity of up to one year increased in the section of the trading period. Nevertheless, an increase in the share of medium and long-term securities in circulation was also observed in 2022.

Conclusions and suggestions

A country with too concentrated a debt profile may find itself at the mercy of strong market pressures when debt is to be renewed. Because of its ties to the local markets, the central bank can provide information regarding the local market's capacity for debt. The central bank may measure the capacity of the local market to absorb debt at different maturities. If the central bank can estimate the volume and monthly flow of investable funds, it could assess how much the potential acquisition of sovereign debt by buy-and-hold investors such as pension funds or insurance companies will influence debt auctions.

What are the central bank's options if, despite coordination, government debt issuance actions are contrary to monetary policy actions? The timing and amounts of government securities issuance will not always coincide with the needs of the central bank's open market policy. The government may need to issue securities when the market is already short of liquidity. The central bank must then choose the extent to which it will provide additional liquidity to the market to meet the government's needs. At a minimum, coordination requires that the issuer inform the central bank of its intentions in advance of taking action. The central bank should inform the issuer if it is advisable to adjust the timing and amount of borrowing to better conform to market conditions.

While market forces have played a part in enlarging the banking systems in emerging countries, the legal and institutional environment needs to be reformed to enable them to perform their functions better. The legal and regulatory environment plays a pivotal role in the smooth operation of the financial sector and in the efficient management and integration of capital flows and domestic savings. The value of the claims of financial institutions on borrowers is dependent upon the certainty of legal rights, coupled with the predictability and speed of their fair and impartial enforcement. Legal and regulatory frameworks that empower the regulator and govern the conduct of market participants form the cornerstone of the orderly operation and development of the financial sector. A system that will ensure enforcement of rules and investors' and borrowers' protection will go a long way towards improving access to finance in the countries.

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