



The Central bank of the Republic of Uzbekistan

Liquidity of the banking system

Second half of 2021

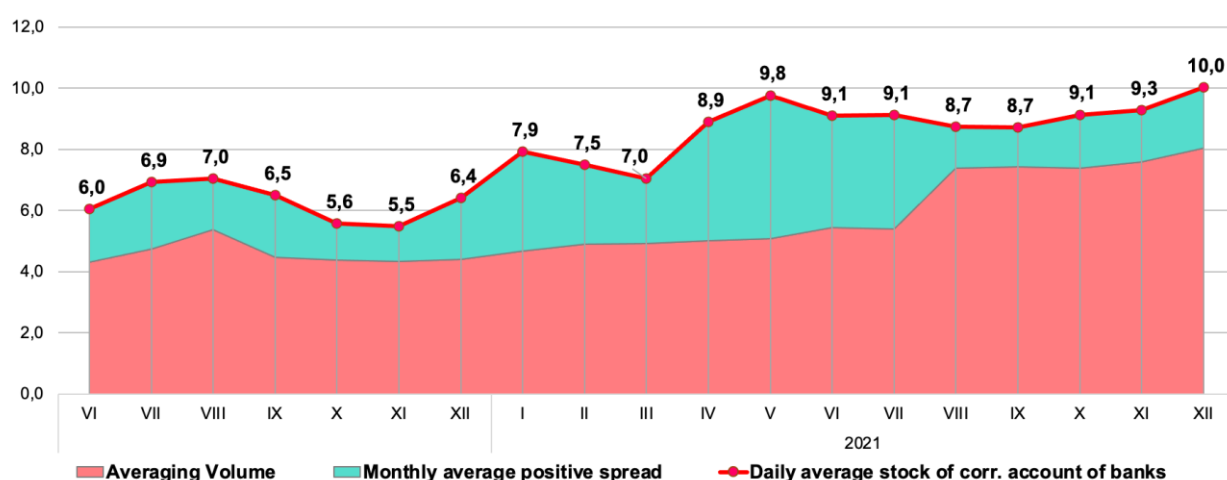
Liquidity of the banking system

In the second half of 2021, the liquidity of the banking system was formed in the context of a sharp increase in government spending and higher aggregate demand in the domestic foreign exchange market than supply. The central bank's net interventions in the domestic foreign exchange market have made it possible to partially sterilize additional liquidity. The non-sterilized part of the excess liquidity was mopped up through the Central Bank's monetary operations.

During this period, there was a significant increase in activity in the primary market of government securities, and the Ministry of Finance regularly issued government bonds within the limits set for the fiscal year. Central bank notes were one of the main instruments for managing liquidity.

The average monthly balance of correspondent accounts of commercial banks with the Central Bank in the second half of the year amounted to **9-10 trln.** sum, which is **1-2 trln.** sum more than the averaging ratio of required reserve. At the same time, the increase in the volume of liquidity operations during the year and the unrestricted implementation of overnight deposit operations from August helped to significantly reduce the positive gap (*Figure 1*).

Figure 1. Liquidity dynamics of the banking system (trln. sum)



In turn, the calculation of the positive difference uses the averaging coefficient of required reserves, and from August 5, due to the increase of this coefficient from 75% to **80%**, the amount of funds to be kept in correspondent accounts of banks for the period amounted to **7.5-8 trln.** sum and was one of the key factors in ensuring the payment system stability.

Liquidity formation factors

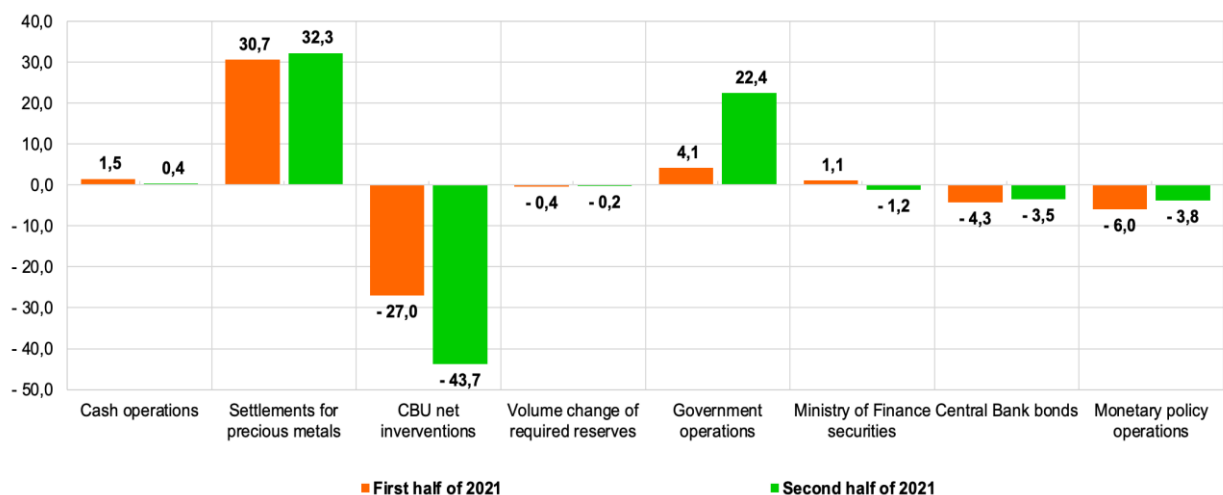
The increase in the liquidity of the banking system in the second half of 2021 was due to an increase in government operations, including government lending programs and investment spending. The demand for liquidity provision operations of the Central Bank sharply decreased, while the volume of operations for attracting liquidity (deposit operations) increased (*Figure 2*).

During this period, the Central Bank's payments for precious metals increased by **5.2%** due to the fact that the average price of gold on the world market was slightly higher than in the first half of the year, while the volume of net interventions of the Central Bank increased by **62%** due to increased demand in the domestic foreign exchange market.

In addition, government securities issued by the Ministry of Finance increased the total liquidity in the first half of the year by **1.1 trln. sum** with an effect of the redemption of previously issued bonds, while in the second half of the year they decreased the total liquidity by **1.2 trln. sum**.

In 2021, the Ministry of Finance issued a total of **4.9 trln. sum** of bonds. The fact that the volume of issues is almost evenly distributed over the months and the pre-announcement of the quarterly issue schedule has played an important role in liquidity management for commercial banks.

Figure 2. Factors of liquidity formation in the banking system (*increasing and decreasing factors, trln. sum*)



In the second half of 2021, the impact of central bank bonds (3.5 trln. sum) and short-term monetary policy instruments (3.8 trln. sum) on overall liquidity was a decreasing factor.

Government operations and government securities

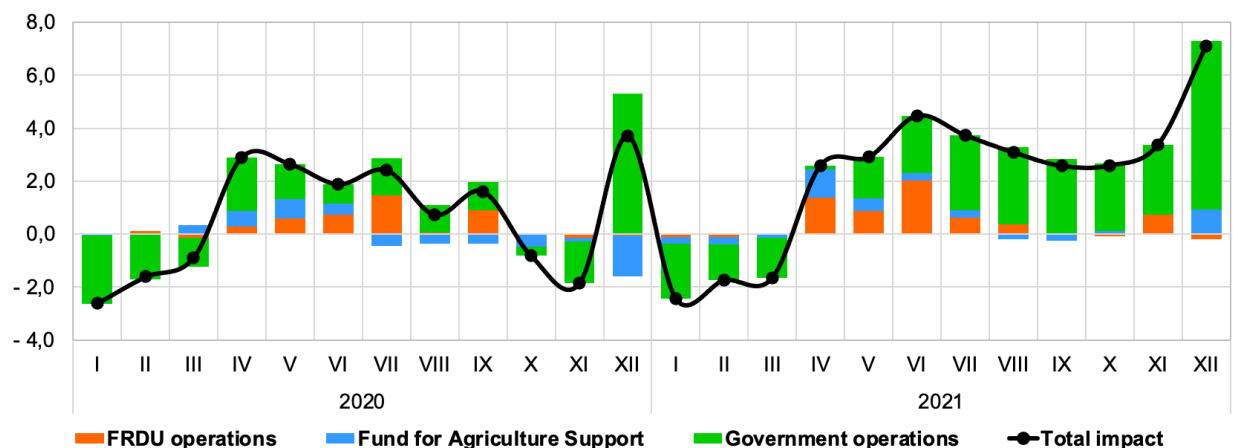
In the second half of 2021, the impact of government operations on the liquidity of the banking system amounted to **22.4 trln. sum**, including:

1) The operations of the **Fund for Reconstruction and Development of Uzbekistan (UFRD)** increased the liquidity of the banking system in the second half of the year by **1.4 trln. sum**, which is explained by the allocation of financial resources for lending to commercial banks on the basis of government programs, in particular, programs to support family entrepreneurship and services;

2) The impact of the **Agricultural Support Fund's** operations on liquidity has increased by **0.9 trln. sum** due to seasonal factors, including the allocation of funds to finance the 2022 harvest;

3) The Single Treasury Account operations in the second half of the year increased the liquidity by **20.1 trln. sum**. It should be noted that, in addition to budget expenditures, temporarily unused funds from the Single Treasury Account and off-budget funds were deposited in commercial banks (Figure 3).

Figure 3. Impact of government operations on banking system liquidity (trln. sum)



Source: Central Bank

From 2022, the impact of government operations on the overall liquidity of the banking system is expected to decrease due to the implementation of budget consolidation and the reduction of the overall fiscal deficit to **3% of GDP**.

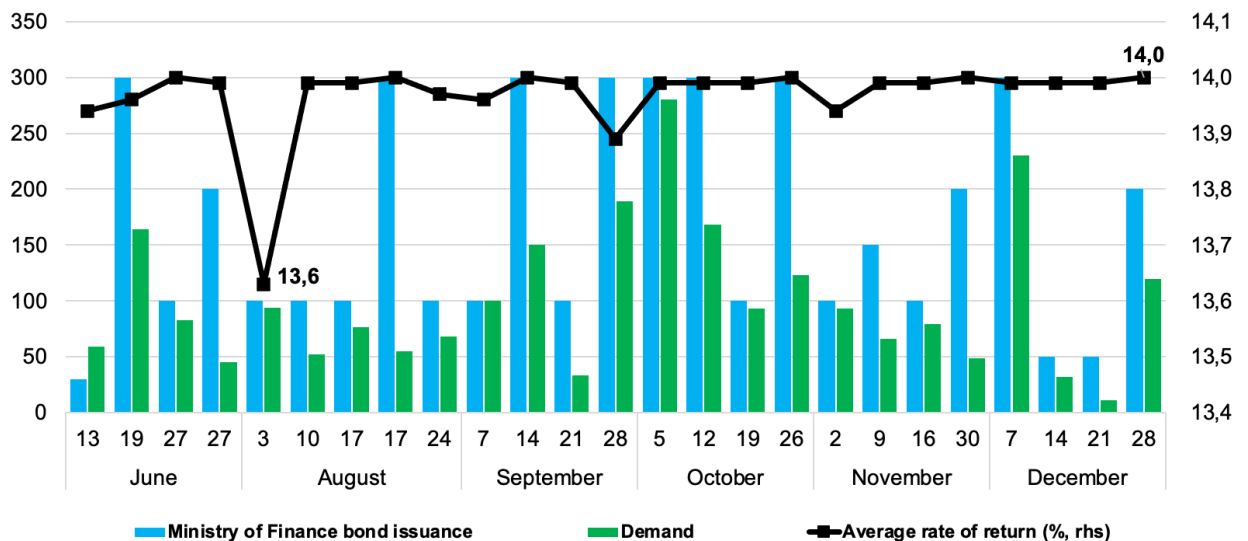
Domestic debt, i.e. the issuance and placement of government securities in commercial banks, has a relatively small share in the sources

of financing this overall fiscal deficit. Article 10 of the Law of the Republic of Uzbekistan "On the State Budget of the Republic of Uzbekistan for 2022" states that the limited net volume of government securities issued on behalf of the Republic of Uzbekistan for 2022 is **6 trln.** sum.

Although the maturity of the bonds of the Ministry of Finance (6 months and above) is longer than the notes of the Central Bank, the rate of return on both bonds is formed around the same rate.

Therefore, the volume of demand for government securities is lower than its supply (volume of issuance) in most cases (*Figure 4*).

Figure 4. Information on government securities issued by the Ministry of Finance in the second half of 2021 (bln. sum)



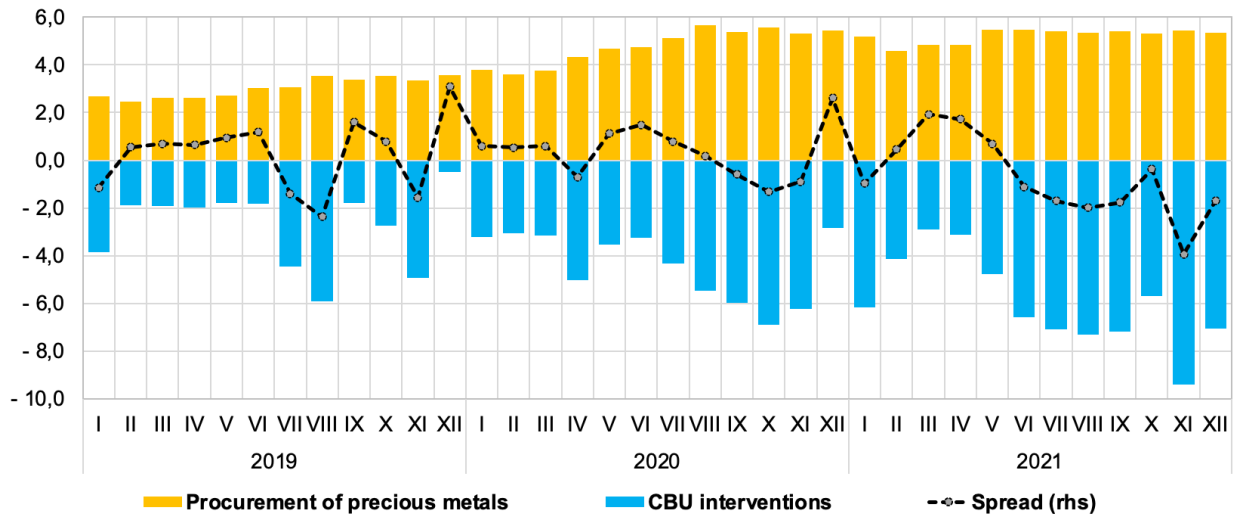
Precious metal procurement and sterilization practices

In the second half of 2021, in the context of rising prices for oil and financial assets due to the recovery of economic activity in the world and accelerating inflation in most countries, the price of gold in the world market formed around \$1,750-1,800 per troy ounce.

The slightly higher price of gold than in the first half of the year, in turn, led to an increase in the Central Bank's payments to producers of precious metals. In particular, in the second half of 2021, the Central Bank made payments to producers **32.3 trln.** sum in total (30.7 trln. sum in the first half of the year).

This excess liquidity, formed through the purchase of precious metals, was sterilized through interventions in the domestic foreign exchange market based on the "principle of neutrality of FX reserves" (Figure 5).

Figure 5. Impact of precious metal procurement and sterilization operations by the Central Bank on the liquidity of the banking system (trln. sum)



In particular, in 2021, the Central Bank's net interventions in the domestic foreign exchange market amounted to **\$6.7 bln.** (equivalent to **71.6 trln. sum**), which allowed to **fully sterilize** the excess liquidity resulting from the purchase of precious metals.

Almost complete sterilization of excess liquidity released into the banking system will allow minimizing the impact of monetary factors that can put pressure on inflation.

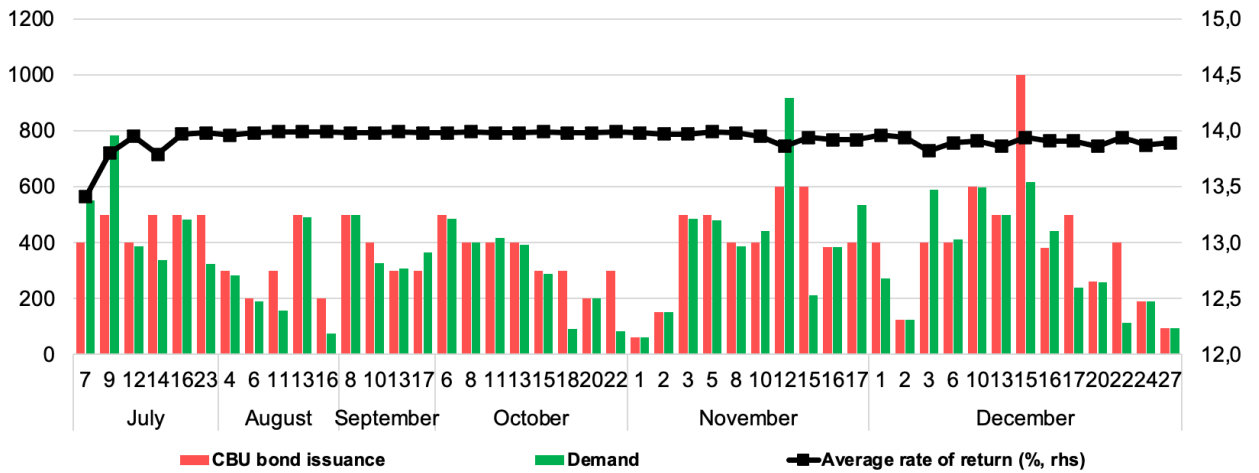
Central bank monetary operations

In the second half of 2021, the Central Bank actively used short-term monetary policy instruments to regulate the overall liquidity level. The volume of these operations depended on the state of liquidity of the banking system and the compliance level of established standards by commercial banks.

To absorb excess liquidity for a longer period, the Central Bank issued a total of **16.2 trln. sum** of notes in the second half of the year, which is **twice** as much as in the first half of the year (Figure 6).

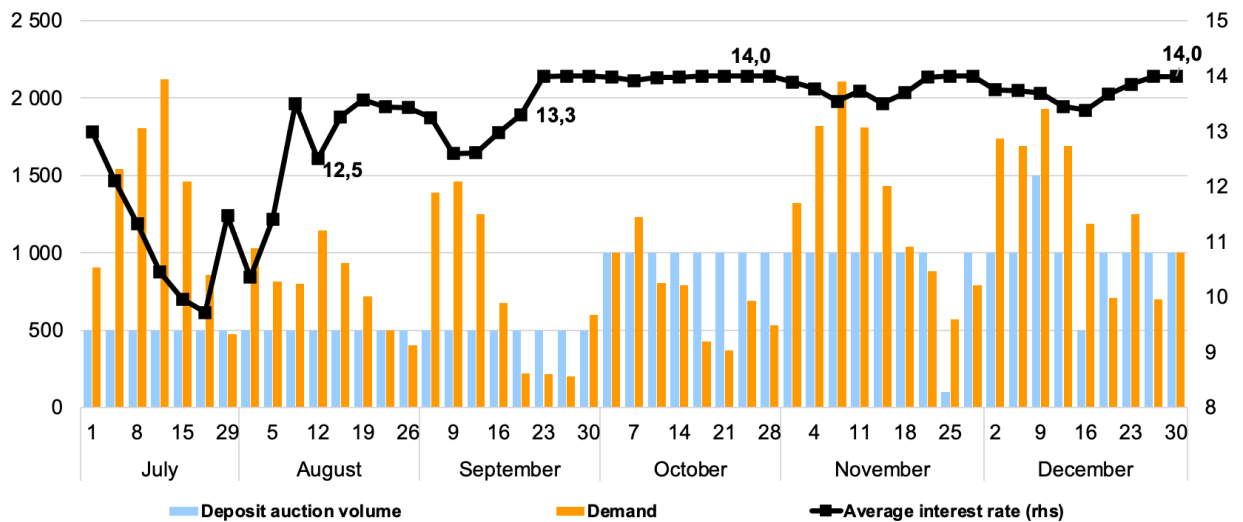
The yield on the issued Central Bank bonds was formed at the level of 14% (policy rate) with small fluctuations.

Figure 6. Information on Central Bank bonds issued in the second half of 2021 (bln. sum)



In turn, the volume of deposit auctions has sharply increased, and since June the volume of daily auctions of the Central Bank in conditions of high liquidity has increased from 200 to 500 bln. sum, and since October it has reached 1 trln. sum. Demand for deposit auctions is high, because the maturity is shorter than for central bank notes, and the upper yield limit is the same (Figure 7).

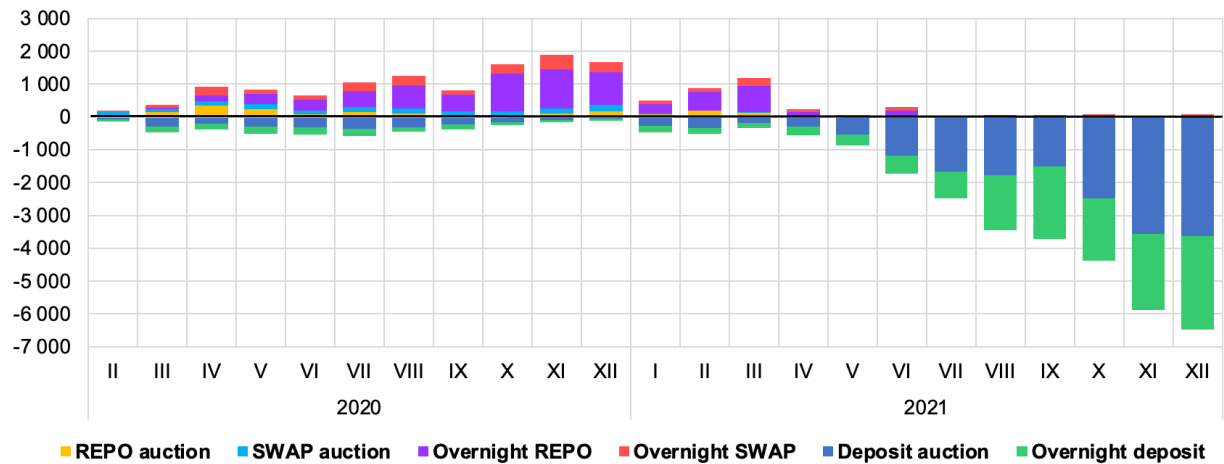
Figure 7. Information on deposit auctions in the second half of 2021 (bln. sum)



As there is no demand for REPO and SWAP **auctions**, they have not been held since August. Demand for overnight REPO and SWAP transactions was also minimal amid rising overall liquidity, and demand for overnight deposit operations increased significantly in August after all restrictions on them were lifted.

In particular, the average daily volume of overnight deposit operations in the second half of the year amounted to about 2 trln. sum, while in the first half of the year it was 270 bln. sum (*Figure 8*).

Figure 8. Daily average balance of monetary operations (bln. sum)



In the future, the Central Bank will continue to pay considerable attention to increasing the capacity to analyze and forecast general liquidity, the active use of monetary policy instruments to effectively regulate liquidity, the organization of effective redistribution of liquidity between banks, in particular, increase their activity in the money market.

One of the important tasks on this agenda is to further improve the set of monetary policy instruments, take the necessary measures to develop the interbank REPO market and the secondary market of government securities.

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