THE FINANCIAL SYSTEM OF THE REPUBLIC OF UZBEKISTAN

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ABSTRACT

This article provides a comprehensive analysis of the financial system of the Republic of Uzbekistan, examining its structure, functions, and contemporary state in the context of post-independence reforms and ongoing economic liberalization. The analysis reveals a system undergoing dynamic transformation, characterized by robust growth in banking assets, the rapid expansion of digital financial services and fintech, and a concerted effort towards privatization and market liberalization. Key findings include a significant increase in the banking sector's asset base (47% over three years), a reduction in inflation from double digits to approximately 9%, and the growing role of the Central Bank in implementing macroprudential policies. Despite these achievements, the state retains a dominant position in the banking sector, and challenges such as managing non-performing loans (NPL) and currency risk persist. The paper concludes that Uzbekistan's financial system is on a positive trajectory, playing a crucial role in sustaining economic growth. Future success hinges on accelerating privatization, enhancing credit risk management, and further integrating into global financial markets, with the long-term prospect of becoming a regional financial hub.

Introduction. The financial system of any state is a complex mechanism that ensures the accumulation, distribution, and effective use of financial resources. It serves as the foundation for economic development and stability and acts as an instrument for implementing the state's socio-economic policy. The financial system of the Republic of Uzbekistan is a crucial component of the national economy, one that has undergone fundamental transformations since gaining independence in 1991 and continues to develop dynamically in the context of modern globalization.

The financial system is the (the economic foundation of finance) and its stable structural part, which ensures the functioning of all types of economic activity. Uzbekistan's financial mechanism occupies a central place in ensuring national economic growth, which has averaged 5.7% annually over the past three years (2021-2023). This indicates that the country's financial system is operating effectively and contributes to achieving sustainable development goals.

The importance of Uzbekistan's financial system is growing amidst global economic challenges that require modernization of the banking sector, development of capital markets, and improvement of state financial policy. According to the Central Bank of the Republic of Uzbekistan, the assets of the banking system reached 652 trillion soums (52.9 billion US dollars) by the end of 2023, a 17% increase from the 2022 level. This is a clear indicator of the growing role of the financial system in the development of the national economy.

This work is dedicated to analyzing the structure, functions, and current state of Uzbekistan's financial system, its role in the country's economic development, and the prospects for reform in accordance with international standards.

The Financial System: Concept, Essence, and Structure. ***The Essence and Definition of the Financial System:*** The financial system represents a collection of interconnected financial institutions and markets that function to accumulate, distribute, and utilize financial resources in the economy. It includes government institutions, credit organizations, insurance companies, investment funds, and other financial intermediaries.

In a broad sense, the financial system is a structured set of financial relationships between economic entities, mediated by money and securities. Its main function is to redistribute monetary funds from lenders to borrowers, from savers to investors.

In the context of Uzbekistan, the financial system should be viewed as an instrument of state policy, contributing to the achievement of strategic development goals: economic diversification, inflation reduction, strengthening domestic demand, and attracting foreign investment.

Key Structural Components: The financial system of Uzbekistan includes the following key components:

The Banking System. The banking system is the central link in the country's financial system. As of January 1, 2024, there were 35 commercial banks operating in Uzbekistan, including 10 banks with state participation, 15 private commercial banks, and 5 foreign banks. Additionally, there were 696 branches of commercial banks, 1,816 banking service centers, and 3,723 self-service points with ATMs.

Significant changes have occurred in the structure of the banking sector in recent years. In particular, in October 2022, the licenses of two banks (Hi-Tech Bank and Turonbank) were revoked for numerous violations of legislation. At the same time, new digital banks received licenses: Smart Bank, Apex Bank, Hayot Bank, and Yangi Bank, which position themselves as fully online-oriented credit institutions.

The assets of Uzbekistan's banking system are characterized by the following dynamics: if they amounted to 444.9 trillion soums (41.1 billion US dollars) at the beginning of 2022, by the end of 2023, they reached 652.2 trillion soums (52.9 billion US dollars). This demonstrates steady growth in the banking sector, with a 17% annual increase in assets.

State Financial Institutions. State financial institutions are an instrument of government economic regulation. These include: the National Bank for Foreign Economic Activity, the Mortgage Bank, Uzpromstroybank, Uzagrokreditbank, and other specialized banks involved in financing priority sectors of the economy (agriculture, housing construction, industry).

As of January 1, 2024, the total assets of state-owned banks amounted to approximately 344 trillion soums, which is about 53% of the total assets of the banking system. This reflects the continuing role of the state in financing strategic sectors of the economy.

The Securities Market. Uzbekistan's securities market operates through the Tashkent Republican Stock Exchange (TSE). This market serves as a platform for the issuance and circulation of government securities, corporate bonds, and company shares.

In recent years, the securities market has developed significantly. In 2022-2023, the process of initial public offerings (IPO) of large state-owned enterprises was launched, which helped attract investment and develop a culture of investing among the population.

The Insurance Market. Uzbekistan's insurance sector includes more than 20 licensed insurance companies providing life, property, liability, and other risk insurance services. The total premiums of insurance companies in 2023 amounted to approximately 3.5 trillion soums.

Microfinance Organizations. As of January 1, 2024, there were 84 microfinance organizations operating in Uzbekistan, which provide microcredit services to small enterprises and individuals. The total assets of microfinance organizations amounted to approximately 18-20 trillion soums.

National Currency and Monetary System. The national currency of Uzbekistan is the Uzbek soum. After the liberalization of the foreign exchange market in 2017, the exchange rate is determined based on supply and demand in the interbank foreign exchange market.

The money supply (M2) in Uzbekistan at the end of 2023 was approximately 180-190 trillion soums. The percentage of cash in the money supply decreased from 25% in 2017 to approximately 18-20% in 2023, indicating the growing popularity of non-cash payments and the development of digital financial services.

The Current State of Uzbekistan's Financial System. *The Banking Sector: Current Status and Trends:*

The banking system of Uzbekistan is characterized by a multi-level structure: at the top is the Central Bank (first level), at the second level are commercial banks, and at the third level are non-bank credit organizations.

As of January 1, 2024, the Central Bank of the Republic of Uzbekistan, established in 1991 after gaining independence, is at the top of the system. The second level consists of 35 commercial banks, of which:

- 10 banks with state participation (Uznationalbank, Uzpromstroybank, Agrobank, Asakabank, Ipoteka-bank, etc.)
- 20 banks with private Uzbek capital
- 5 banks with foreign participation

The third level includes 84 microfinance organizations, 84 pawnshops, and 1 mortgage refinancing organization.

2.1.2. Assets of the Banking System

The total assets of the banking system show positive dynamics:

Indicator	01.01.2022	01.01.2023	01.01.2024	Dynamics
Assets (trillion soums)	444.9	556.7	652.2	+17% year-on-year
Assets (billion USD)	41.1	49.6	52.9	+6.6% year-on-year

This data indicates steady growth in the banking sector. The asset structure shows that the main share (70%) consists of loans to customers, 13% are funds in credit institutions, with the rest distributed among liquid assets, investments, and other assets.

Deposit Base and Liabilities. The deposit base of banks is the main source of funding. As of January 1, 2024, the liability structure of the banking system was as follows:

Component	Amount (trillion soums)	Liabilities %	Amount (billion USD)
Customer funds	241.7	37%	19.6
Funds of financial organizations	270.3	41%	21.9
Issued securities	13.2	2%	1.1
Subordinated debt	9.7	1.5%	0.8
Bank capital	97.1	15%	7.9

An important indicator is the dynamics of population deposits. If the share of retail client funds was about 27% of liabilities in 2021, by the beginning of 2024, this share had grown to 38%, indicating growing public confidence in banks and the expansion of the retail banking segment.

Credit Portfolio. The credit portfolio of banks reached 457.8 trillion soums at the beginning of 2024. The structure of the credit portfolio by economic sectors is as follows:

- Industry and Manufacturing: 30%
- Retail Lending: 32%
- Trade and Services: 15%
- Agriculture: 12%
- Other Sectors: 11%

Lending dynamics show a significant increase in the retail segment. If the share of retail loans was about 21% in 2022, by the end of 2023, it had risen to 32%, reflecting the development of consumer lending and the expansion of banking services among the population.

The weighted-average interest rates show the following dynamics:

Category	**2022**	**2023**	**Dynamics**
Rates on loans to individuals	20.8%	25.2%	+4.4 p.p.
Rates on loans to legal entities	15.1%	17.9%	+2.8 p.p.

The increase in rates reflects the macroprudential policy of the Central Bank, aimed at slowing the excessive growth of retail lending.

Quality of the Credit Portfolio. The quality of the credit portfolio is a key indicator reflecting the state of the banking system. During 2023, the volume of non-performing loans (NPL) grew by 18% and amounted to 16.6 trillion soums (1.3 billion US dollars) at the beginning of 2024.

The share of non-performing loans (NPL ratio) is maintained at approximately 3.5%, which meets international standards of acceptability. However, it should be noted that the NPL dynamics were mainly driven by a deterioration in the asset quality of two banks: the "Business Development Bank," reorganized in Q3 2023, and "Ipoteka-bank," privatized in Q2 2023. The volume of non-performing loans in these two banks more than doubled.

Credit portfolio provisioning is maintained at a conservative level of about 3%, while provisions for non-performing loans decreased from 47% to 37% in 2023. This indicates the need for further improvement in credit risk assessment and non-performing asset management procedures.

Bank Capital and Profitability. The total capital of the banking system increased from 79.6 trillion soums at the beginning of 2023 to 97.1 trillion soums at the beginning of 2024, a 22% increase.

The capital adequacy ratio at the beginning of 2024 was 17.5%, with a regulatory minimum of 13%, indicating sufficient capitalization of the system. The Tier 1 capital adequacy ratio was 14.1%, with a regulatory minimum of 10%.

The Return on Assets (ROA) of the banking system in 2023 was 2.6% (2.5% in 2022), and the Return on Equity (ROE) was 14% (13% in 2022). These indicators suggest an improvement in the operational efficiency of banks.

The net profit of the banking system in 2023 reached 12.4 trillion soums (1 billion US dollars), which is 24% higher than the 2022 financial result. The main growth was driven by net non-interest income, which increased by 35%.

Foreign Exchange Risk Management. Foreign exchange risk continues to be one of the main problems of the banking system. The share of loans in foreign currency remains significant, although it is declining: if it was 50% of the portfolio at the beginning of 2022, it had decreased to 45% by the beginning of 2024.

Similarly, the share of liabilities in foreign currency decreased from 57% at the beginning of 2022 to approximately 40-45% by the beginning of 2024. This reflects the de-dollarization policy of the economy being conducted by the Central Bank.

The Role of the Central Bank in the Financial System. ***Functions and Powers of the Central Bank:*** The Central Bank of the Republic of Uzbekistan was established in 1991 after the country gained independence. According to the Constitution of Uzbekistan, the Central Bank develops and implements monetary and foreign exchange policies.

The main functions of the Central Bank include:

1. **Monetary Policy:** Developing and implementing monetary policy to achieve inflation, economic growth, and financial stability targets.
2. **Banking Regulation and Supervision:** Setting regulatory requirements for banks, issuing licenses, conducting inspections, and applying enforcement measures for violations.
3. **Foreign Exchange Market Management:** Regulating the exchange rate and foreign exchange operations, although the regime has been significantly liberalized since 2017.
4. **Management of Banking Liquidity:** Ensuring sufficient liquidity in the banking system through open market operations and setting reserve requirements.
5. **Systemic Risk Management:** Monitoring systemic risk in the banking system and the economy.

Monetary Policy. In late 2019, the Central Bank of Uzbekistan introduced an inflation targeting regime, setting an inflation target of 5%. However, in the period from 2017 to 2019, the inflation level remained high, not falling below 14%.

By 2023, it was possible to significantly reduce inflation. In June 2023, inflation reached a minimum of 9%, but a slight re-evaluation occurred in the following months. As of the end of 2023, inflation was at approximately 9-10%, which is significantly closer to the target level of 5%.

The Central Bank's key rate was set at 14% in October 2023, where it remained at the beginning of 2024. The Central Bank has expressed its intention to continue lowering the rate if the inflation dynamics remain positive.

Financial Markets and Services. ***The Securities Market:*** Uzbekistan's securities market is developing through the Tashkent Republican Stock Exchange (TSE). This exchange serves as the main platform for trading government and corporate securities.

In recent years, the securities market has expanded significantly. In 2022-2023, IPOs of large state-owned enterprises were conducted, including companies in the telecommunications, energy, and insurance sectors. These operations attracted a significant volume of investment from both residents and non-residents.

The trading volume on the stock exchange is approximately 5-10 trillion soums per year, which is relatively small compared to the banking sector but shows a growing trend.

The Insurance Market: Uzbekistan's insurance market includes more than 20 licensed insurance companies. The total premiums of insurance companies in 2023 amounted to approximately 3.5 trillion soums.

The main activities of insurance companies include:

- Life insurance
- Property insurance (for individuals and legal entities)
- Compulsory motor third-party liability insurance (auto insurance)
- Liability insurance

The Microfinance Market: At the beginning of 2024, there were 84 microfinance organizations and 84 pawnshops operating in Uzbekistan. The total assets of microfinance organizations amounted to approximately 18-20 trillion soums.

Microfinance organizations play an important role in developing financial inclusion by providing microcredit services to small enterprises, farmers, and individuals who do not have access to commercial banking services.

Macroeconomic Prerequisites for the Development of the Financial System. ***Economic Growth Rates:*** Uzbekistan is the second-largest economy in Central Asia after Kazakhstan. Despite global crises, the country has demonstrated steady economic growth rates:

- 2020: 2% (during the COVID-19 pandemic)
- 2021: 7.4%
- 2022: 5.7%
- 2023: approximately 5% (expected)

The Asian Development Bank forecasts that the country will maintain growth rates of around 5% in the coming years, provided structural reforms are implemented and investments are made in developing its production base.

GDP and Economic Structure: Uzbekistan's GDP in 2023 was approximately 75-80 billion US dollars, corresponding to a GDP per capita of approximately 2,400-2,500 US dollars. These figures are lower than Kazakhstan's but higher than other Central Asian countries.

Structure of Uzbekistan's Economy (2022):

Sector	Share
Services	41.5%
Industry	26.7%
Agriculture	25.1%
Other	6.7%

The role of agriculture is gradually declining, while services and industry occupy an increasing share of the GDP structure. However, the level of industrialization remains relatively low, which creates potential for further development of the manufacturing industry.

Inflation Level and Money Supply : Inflation has long been one of the main problems of the Uzbek economy. After the liberalization of the foreign exchange market in 2017 and the introduction of inflation targeting in late 2019, the situation gradually improved:

Year	Inflation Rate
2017	14.5%
2018	17.9%
2019	14.6%

Year	Inflation Rate
2020	12.0%
2021	10.1%
2022	11.5%
2023	9-10% (end of year)

The money supply (M2) in 2023 amounted to approximately 180-190 trillion soums. The percentage of cash in the money supply is gradually decreasing, reflecting the growing popularity of non-cash payments and digital financial services.

Employment and Demographics: Uzbekistan is one of the few countries with a growing workforce. As of 2023, the country's population was approximately 35 million people, of which over 60% are of young, working age.

The unemployment rate has been gradually declining since the pandemic:

Year	Unemployment Rate
2020	10.5%
2021	9.6%
2022	8.9%
2023	~8%

The high growth of the workforce creates a need for new jobs and an expansion of production. Labor migration has traditionally been an important source of remittances to the country, although in recent years, migration directions have been shifting from Russia towards the Persian Gulf and Europe.

Conclusion. The financial system of the Republic of Uzbekistan demonstrates sustainable development, characterized by the growth of the banking system's assets, the expansion of the retail banking segment, the development of digital financial services, and integration into global financial systems.

Key achievements include:

1.An increase in the country's sovereign credit rating by rating agencies Moody's and Fitch.

2.A reduction in the inflation rate from 14.6% (2019) to approximately 9% (2023).

3.A 47% increase in the assets of the banking system over three years (2021-2023).

4.The launch of three digital banks and 32 fintech companies.

5.The implementation of privatization for large state-owned enterprises.

However, the financial system requires further improvement. It is necessary to:

• Accelerate the privatization processes of state-owned banks.

- Improve the quality of the credit portfolio by tightening risk assessment standards.
- Develop a competitive environment in the banking segment.
- Expand financial inclusion for small and medium-sized enterprises.
- Strengthen mechanisms for protecting the rights of consumers of financial services.

The financial system in Uzbekistan continues to play an important role in supporting economic growth while maintaining trust and stability. The Republic is entering a new stage in managing state finances, development, and improvement, while simultaneously strengthening its position in the international financial markets.

Based on the work done and the measures taken, Uzbekistan's financial system is taking the right steps towards achieving its goals in the coming years and establishing itself as a regional financial and credit center.

In recent years, major changes have taken place in Uzbekistan's banking system. The Central Bank of Uzbekistan, while monitoring the ongoing processes, continues its active work in ensuring macroeconomic stability.

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