

CENTRAL BANKS' INTEREST RATE POLICY AND THE FIGHT AGAINST INFLATION*Samarkand Branch of**Tashkent State University of Economics,**Student: Ashraf Turdialiye**e-mail: ashrafjon9004@gmail.com**ORCID ID: 0009-0002-2708-9976**Student: Shokhzod Khujamurotov**e-mail: br.shahkzod@gmail.com**ORCID ID: 0009-0009-1610-6508*

Abstract: This article analyzes the mechanism by which central banks combat inflation through interest rate policy. In recent years, the surge in global inflation has prompted many countries to raise interest rates in an effort to ensure price stability. The article examines the practical outcomes of interest rate policy based on the experiences of countries such as the United States, the European Union, Turkey, and Uzbekistan. Additionally, the theoretical foundations of this policy are highlighted through the views of economists such as Paul Krugman and John Taylor. The author emphasizes the necessity of integrating interest rate policy with other macroeconomic measures, arguing that an effective approach to combating inflation requires a comprehensive set of actions.

Аннотация: В данной статье анализируется механизм борьбы центральных банков с инфляцией через политику процентных ставок. В последние годы рост глобальной инфляции побудил многие страны повышать процентные ставки с целью обеспечения ценовой стабильности. В статье рассматриваются практические результаты политики процентных ставок на основе опыта таких стран, как США, Европейский Союз, Турция и Узбекистан. Также через взгляды экономистов, таких как Пол Кругман и Джон Тейлор, демонстрируются теоретические основы этой политики. Автор подчеркивает необходимость интеграции политики процентных ставок с другими макроэкономическими мерами, утверждая, что эффективный подход к борьбе с инфляцией требует комплексных действий.

Keywords: Central bank, interest rate, inflation, monetary policy, economic stability, Paul Krugman, Taylor Rule, inflation targeting, macroeconomic policy, economic growth, price stability.

Ключевые слова: Центральный банк, процентная ставка, инфляция, денежно-кредитная политика, экономическая стабильность, Пол Кругман,

правило Тейлора, таргетирование инфляции, макроэкономическая политика, экономический рост, ценовая стабильность.

Introduction: The Central Bank's interest rate is a fundamental economic tool used by central banks to regulate a country's economy. It refers to the rate at which a central bank lends money to commercial banks or financial institutions. This interest rate significantly impacts various economic variables, such as consumer spending, business investment, inflation, and overall economic growth. By adjusting this rate, central banks can manage inflation, stabilize the economy, and influence economic growth in a country. The central bank's interest rate acts as a primary instrument for implementing monetary policy. When the central bank raises interest rates, borrowing money becomes more expensive. This reduction in borrowing discourages spending by consumers and businesses, which can help cool down an economy that is growing too quickly, potentially causing inflation to rise.

On the other hand, when the central bank lowers the interest rate, borrowing becomes cheaper, encouraging consumers and businesses to spend more. This can stimulate a sluggish economy by increasing demand and investment. Through these adjustments, central banks can ensure that inflation remains at a manageable level, fostering economic stability. Central banks' interest rates are also closely tied to the broader concept of economic growth. When interest rates are low, consumers are more likely to take out loans for purchasing homes, cars, and other big-ticket items, while businesses are more inclined to borrow money for investment in new projects or expansion. This increased spending and investment can drive economic growth, create jobs, and improve productivity. Conversely, when the central bank raises interest rates, borrowing becomes more costly, leading to reduced consumer and business spending, which can slow down the economy. In addition to their role in economic growth and inflation management, central banks' interest rates also affect exchange rates and international trade. When interest rates are high, a country may attract foreign investment, as investors seek higher returns on their investments. This influx of capital can strengthen the national currency, making imports cheaper and affecting the overall trade balance.

Conversely, lower interest rates may lead to a weaker currency, making exports more competitive on the global market. The central bank's interest rate also directly influences bank lending rates. Commercial banks set their lending rates based on the central bank's interest rate, meaning that changes to the central bank's rate can have a ripple effect throughout the economy. For example, when the central bank increases its interest rate, commercial banks are likely to raise their lending rates as well. This increase in borrowing costs can lead to reduced demand for loans, affecting everything from mortgages to business loans, and ultimately slowing down economic activity. The

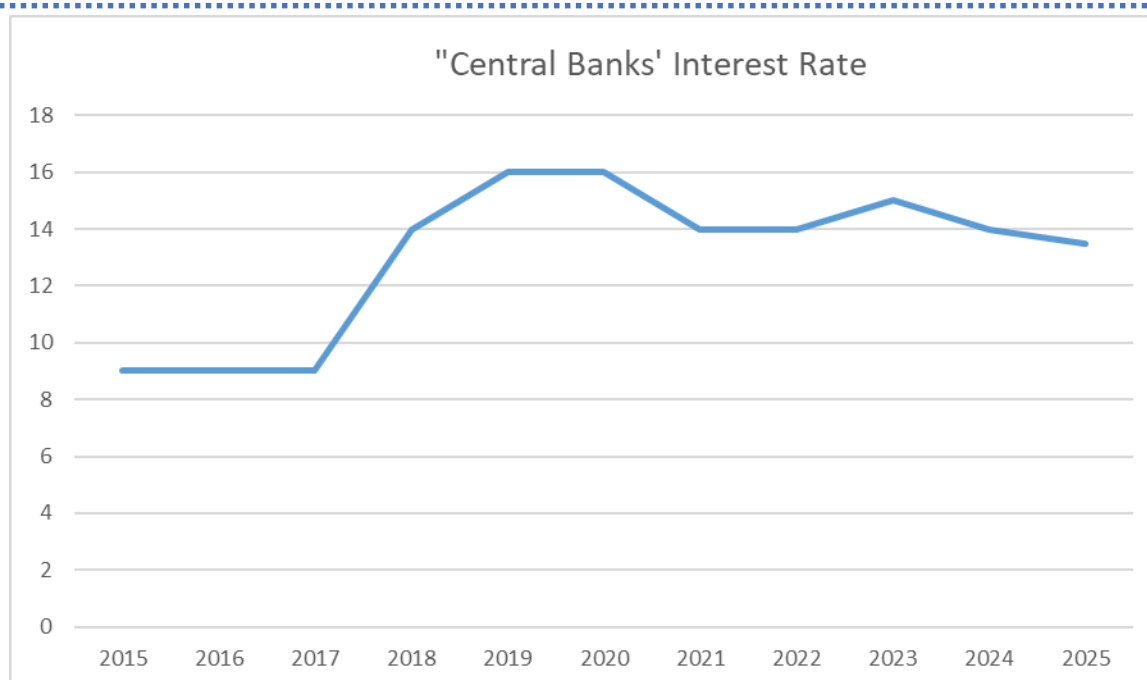
central bank's interest rate, therefore, plays a crucial role in shaping the overall economic environment. By adjusting the rate, central banks are able to influence inflation, stimulate or slow down economic growth, manage exchange rates, and guide the behavior of financial institutions and consumers. As a result, this tool is essential in maintaining a balanced and stable economy, ensuring that inflation remains under control while encouraging sustainable economic development.

In recent years, the global economy has fallen into an unprecedented crisis. The COVID-19 pandemic, the Russia-Ukraine war, the energy crisis, and disruptions in logistics chains have led to a sharp rise in global prices, resulting in heightened inflation. According to the 2023 report of the International Monetary Fund, the average inflation rate worldwide reached 8.7%, one of the highest figures in the past 40 years. In this context, central banks have intensified their fight against inflation by tightening one of their main economic tools—interest rate policy. The practical implementation, effectiveness, and complexities of this policy are currently at the center of global economic discussions.

Interest rate policy is the practice of regulating the money supply by raising or lowering the key interest rates to influence economic activity. When interest rates rise, loans become more expensive, which reduces expenditures by economic agents, decreases domestic demand, and, as a result, inflationary pressures subside. Conversely, when interest rates are lowered, economic activity increases, but inflation risk also rises. Although this mechanism may seem simple at first glance, its effects on the economy are complex and multifaceted.

The experience of major countries provides important lessons. For example, the U.S. Federal Reserve System has raised interest rates gradually from 0.25% to 5.5% since 2022. As a result, inflation in the U.S. reached 9.1% in 2022, but by the beginning of 2024, this figure had dropped to 3.1%. The European Central Bank increased its interest rate from 0% to 4%, successfully reducing inflation from 10% to 5%. In emerging economies like Turkey, the situation became more complicated: when inflation reached 64.8% at the end of 2023, the central bank raised interest rates to 45%. This measure was necessary to curb the depreciation of the lira and ensure price stability.

Uzbekistan also actively applied interest rate policy to combat inflation. The Central Bank raised the key rate to 17% in 2022. This measure played a significant role in controlling inflation, which was around 12%. According to the latest data, as of March 2024, inflation stands at 8.2%, and the interest rate remains at 14%. This relatively conservative approach reflects the Central Bank's commitment to price stability.



"Central Banks' Interest Rate in Uzbekistan between 2015 and 2025"

Economists have different approaches to interest rate policy. For instance, Nobel laureate Paul Krugman acknowledges that raising interest rates reduces inflation but stresses that such measures may negatively impact long-term economic growth. According to him, supporting production and employment through lower interest rates may be more important than fighting inflation. On the other hand, the famous "Taylor Rule," developed by John Taylor, advocates setting interest rates based on the inflation rate, offering central banks a clear formula for action. This approach strengthens the independence of central banks and increases confidence in financial markets.

However, the effectiveness of interest rate policy is not always positive. High interest rates can lead to a reduction in investment, an increase in unemployment, and slower economic growth. Particularly in developing countries, where households have high levels of debt, raising interest rates makes mortgages, education, and business loans more expensive, which negatively impacts the well-being of the population.

To implement interest rate policy correctly, it must be coordinated with other economic measures. For example, a coordinated approach involving fiscal policy (taxes and government spending), exchange rate policy (currency management), price controls, and subsidies can provide more effective results in fighting inflation. Many countries are currently adopting an "inflation targeting" strategy, which sets a target inflation rate (usually 2-3%) and adjusts monetary policy accordingly.

In conclusion: Central banks' interest rate policy plays a pivotal role in managing inflation and ensuring economic stability. While this tool is highly effective in controlling domestic demand and regulating the money supply, its impact on economic growth and social welfare cannot be overlooked. As demonstrated by the experiences of countries like the United States, the European Union, Turkey, and

Uzbekistan, the effectiveness of interest rate adjustments varies depending on the economic context. A balanced and carefully calibrated approach, integrating interest rate policy with other macroeconomic measures such as fiscal policies and inflation targeting, is essential for maintaining both price stability and sustainable growth. The challenge for central banks today lies in striking the right balance between controlling inflation and fostering long-term economic development while safeguarding the well-being of citizens. Thus, a comprehensive and flexible approach remains the key to successfully combating inflation in an increasingly complex global economic landscape.

REFERENCES:

1. Central bank of Uzbekistan <https://cbu.uz/uz/monetary-policy/refinancing-rate/>
2. <https://Lex.uz> website
3. Blinder, A. S. (1998). *Central Banking in Theory and Practice*. MIT Press.
4. Mishkin, F. S. (2015). *The Economics of Money, Banking, and Financial Markets* (10th ed.). Pearson.
5. Bernanke, B. S., & Gertler, M. (1995). *Inside the Black Box: The Credit Channel of Monetary Policy Transmission*. *Journal of Economic Perspectives*, 9(4), 27–48.
6. Friedman, M., & Schwartz, A. J. (1963). *A Monetary History of the United States, 1867–1960*. Princeton University Press.
7. Bordo, M. D., & Humpage, O. F. (2014). *Central Banking: Theory and Practice in Sustaining Monetary and Financial Stability*. Cambridge University Press.
8. Romer, D. (2018). *Advanced Macroeconomics* (5th ed.). McGraw-Hill Education.
9. Gertler, M., & Gilchrist, S. (1994). *Monetary Policy, Business Cycles, and the Behavior of Small Manufacturing Firms*. *Quarterly Journal of Economics*, 109(2), 309-340.