MBENEFITS OF DEVELOPING REPO TRANSACTIONS MARKET IN UZBEKISTAN

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https://doi.org/10.5281/zenodo.11368549

Abstract. *This article examines the imperative role of REPO transactions markets in enhancing liquidity positions of financial institutions in the banking system of Uzbekistan. It explores the country's emerging REPO market and the associated challenges and opportunities. Through a comprehensive analysis of ongoing banking industry reforms, innovative approaches of the Central Bank of the Republic of Uzbekistan to monetary policy, best practices of the World's leading economies in this field, the study identifies key issues hindering further development of REPO markets and proposes practical solutions. By addressing these challenges, Uzbekistan can capitalize on the opportunities offered by the development of REPO markets not only for ensuring enhanced liquidity of the commercial banks and therefore stability of the banking system, but also for achieving sustainable growth in other sectors of the Economy as well .*

Keywords*: REPO (repurchase) agreements, liquidity, monetary policy, financial risks, financial risks management, financial crisis, monetary policy, monetary policy tools*

1. METHODOLOGY

This article makes use of the secondary research approach i.e. findings highlighted in the existing articles and publications will be explored in order to find out the most successful best practices deployed by Central Bank institutions, economists and policy makers in the advanced economies of the World. This approach not only allows the author to come up with the most appropriate best practices to be recommended to the Central Bank of the Republic of Uzbekistan (referred to as CBU hereafter), but also it points out what are the bitter lessons and potential pitfalls involved in developing REPO markets that Western economies had to experience before.

Furthermore, this article will also demonstrate some aspects of comparative analysis in order to customize the World's best practices as much as possible to the current needs of the banking system in Uzbekistan and the country's entire economy.

2. OVERVIEW OF REPO MARKETS

Repurchase (REPO) transactions markets are markets in which securities are exchanged for cash with an agreement to repurchase the securities at a future date. In the transaction, securities serve as collateral for what is effectively a cash loan. The securities which are used as collateral in repos are government debt securities such as T-bonds (Treasury bonds), however private sector debt instruments such as commercial paper or corporate bonds can also be used as a collateral for this purpose.

According to the legislation in the United States, where repurchase agreements originated, REPOs can be of any maturity. However, three types of maturity are the most common – overnight, open and term. Overnight repurchase agreements have a single day maturity, whereas term repos are the ones that have fixed maturity of more than one day. The open maturity REPOs are basically overnight REPOs that can be extended as per the consent by the two parties to the agreement.

According to the Bank for International Settlements (1999), the use of repurchase operations to obtain funds is perhaps the most straightforward use of this transaction, as it can be compared to a collateralized loan. From this point of view, the principal merit of repos is the generally lower cost of financing relative to the uncollateralized market. For the lender of cash, the advantage is the provision of collateral to limit credit risk.

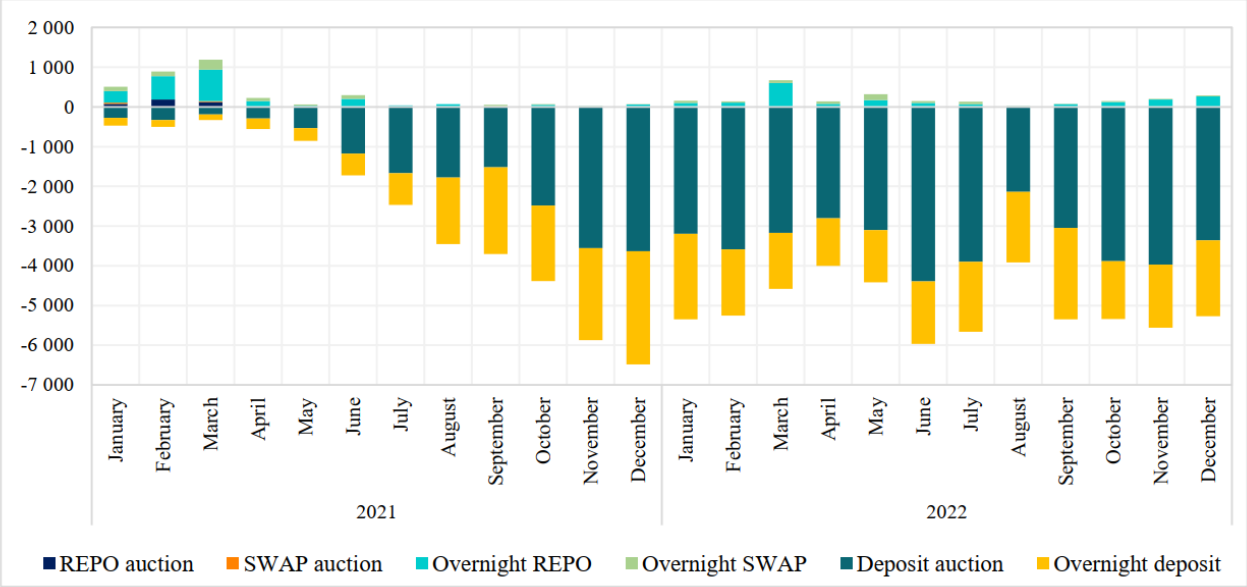
The repurchase agreement (repo) market is also perceived as a potential source of instability since the financial crisis of 2007-2009 (see Gorton and Metrick (2012), Adrian and Shin (2011), and Copeland et al. (2014) among others).

Nevertheless, for several decades already the Central Banks of G7 countries have been using REPOs as a very effective and efficient tool of monetary policy that helps their economies to recover faster from the crisis during the recessions and to achieve sustainable economic growth rates during the expansions in the business cycle.

3. CURRENT STATE OF THE REPO MARKET IN UZBEKISTAN

Figure 3.1.5

Short-term transactions balance of the Central Bank,
monthly average daily balance, in billion soums



The Figure 3.1.5. above is taken from the Annual Report 2022 of the Central Bank of the Republic of Uzbekistan (2022). This Figure shows short-term transactions balance of the CBU in 2021 and 2022. According to the CBU (2022), Owing to the seasonal decline in government spending and the external concerns that emerged in March, the need for operations to attract cash declined slightly in the first quarter of 2022, while the need for overnight REPO and SWAP operations to provide liquidity increased.

According to the CBU (2024), based on the experience of advanced foreign countries and international financial markets that have transited to the inflation targeting regime, the following changes will be introduced **from February 20, 2024**, in order to develop the operational framework of monetary policy and increase the efficiency of liquidity management in commercial banks:

1. Based on the overall liquidity condition in the banking system, the practice of holding **1-week REPO auctions** will be introduced to **provide liquidity** to banks.

REPO auctions are held on **Mondays** at 11:00 a.m. and serve to provide liquidity to commercial banks during the week. These auctions are carried out at a variable interest rate *(minimum – policy rate)* in a fixed amount based on the banking system's liquidity forecast.

2. **Intraday credit instrument** of the Central Bank for providing liquidity to commercial banks – interest-free credit operations will be introduced until the closure of the bank payments with clients. The main purpose of using this instrument is to ensure the **continuity of payments** in the banking system and to provide banks with the necessary liquidity during the day.

It is envisaged that the banks will use the funds attracted through this instrument during the day and return them by the end of the client payments. Intraday loan instruments that are **not repaid** before the closure of bank settlement day are automatically converted into interest-bearing overnight operations.

3. The operating hours of **interbank money and REPO markets** will be extended until **30 minutes** after the closure of bank payments with clients as well as banks will be able to use the **overnight operations** of the Central Bank within **1 hour** after the closure of the bank payments.

As a result of this change, after the completion of payment operations with the clients of commercial banks, there will be an opportunity to **redistribute liquidity** among themselves and then apply to the operations of the Central Bank. In this case, the activity of banks in the interbank money and REPO markets is expected to increase further.

4. In order to minimize the credit risk in the implementation of monetary operations, a **5 percent haircut** will be applied to collateral property for liquidity providing operations.

Improvements mentioned above will provide more flexibility and convenience to commercial banks in liquidity management, ensure the continuity of the payment system, and minimize the credit risk of monetary operations.

4. CHALLENGES

To fully reap the benefits of the advanced REPO market the following challenges need to be overcome in Uzbekistan:

Capacity building *- developing the necessary expertise within financial institutions and their customers/counterparties to the REPO transactions stands as a common challenge. This includes training professionals to fully understand all of the aspects of REPO transactions, including risk management issues involved in REPOs, in order to design and implement this kind of transactions effectively and efficiently so to enhance the liquidity position and improve the risk management practices not only from the point of view of the financial institutions but also from the perspective of their customers/counterparties to the REPO agreements.*

The banking system's and financial markets' own further institutional development *– a lack of well-developed financial markets in Uzbekistan, such as domestic bond markets for instance, currently doesn't allow for various types of securities, including private sector securities like commercial papers or corporate bonds, to be used as a collateral in REPO contracts. This in turn limits possibility not only for the financial institutions but also for all of the firms in the economy to make effective use REPOs for the purposes of managing their liquidity positions as well as financial risk management purporses.*

Legislation framework *– clear, supportive and flexible legislation frameworks should be in place in order to regulate the further development of the entire financial system in the country including its components – institutional development of financial institutions and development of financial markets including REPO markets.*

5. BENEFITS OF DEVELOPING REPO MARKET

If Uzbekistan can succeed in developing its REPO market, its economy can reap the following benefits:

- All the firms in the economy including financial institutions can use REPO transactions to improve their liquidity position and therefore to avoid bankruptcy cases.

- One of the obvious advantages of repurchase agreements is the fact that when banks are refusing to the customer in lending the money because of the customer's shaky financial position, that firm can raise funds by making a REPO agreement. Since in REPOs some of the borrower's assets e.g. a financial security is pledged as collateral, this feature of REPO transactions minimizes default risk and therefore financial institutions are readily lending the money.

- The CBU can make use of the REPO transaction as a very effective tool of the monetary policy to improve the liquidity position of the commercial banks and therefore to ensure stability of the entire banking system.

- REPOs can also be used by the CBU for the management of foreign currency reserves as it is very widely practiced by the Central Banks of the advanced economies in the World such as the Federal Reserve System of the United States, Bank of England, the European Central Bank, etc.

The above mentioned benefits are just a few examples of numerous advantages offered to the economy by a well-developed REPO market.

6. CONCLUSION

In conclusion, despite the challenges on the way of developing efficient REPO market in Uzbekistan, if the country will succeed in achieving this goal, then the Economy of Uzbekistan will obtain numerous benefits and advantages.

Advanced REPO transactions market not only will enhance the liquidity of the banking system, but it will also help the CBU ensure the stability of the entire Economy of the country.

For several decades already the Central Banks of G7 countries have been using REPOs as a very effective and efficient tool of monetary policy that helps their economies to recover faster from the crisis during the recessions and to achieve sustainable economic growth rates during the expansions in the business cycle.

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