Research Article

Monetary Policy Of Developing Countries In Inflationary Processes

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Article History: Received: 11 January 2021; Revised: 12 February 2021; Accepted: 27 March 2021; Published online: 16 April 2021

Annotation : This article examines the issue of inflationary processes, in which the macroeconomic situation in developing countries is in a deplorable state, when the state is faced with the choice of active application of two macroeconomic policies, this is either fiscal policy or monetary policy. The purpose of this article is to consider macroeconomic stability from the point of view of monetary policy, since the state budget deficit that has arisen in the economy requires an optimal combination, as well as the introduction of the right financial instruments. Thus, the article focuses on the macroeconomics of developing countries, and then considers the theory of eliminating inflationary processes. A detailed theoretical analysis is provided, strengths and weaknesses of monetary policy are indicated, its application in practice to developing countries with a small open economy based on the short and long term aspects. Several options are being considered to eliminate inflationary processes. Monetary policy is examined in detail. The positive impact of devaluation on the country's economy, as well as a brief overview of the monetary policy of the PRC to eliminate inflationary processes, the experience of China in attracting foreign currency, that is, capital inflow, is considered. The purpose of this article is to show the ways of solving inflationary processes that arise in developing countries applying an active monetary policy.

***Keywords*:** inflation, macroeconomic stability, currency, efficiency, profitability, intensive growth, financial stability, production process, inflation targeting, competitiveness, floating exchange rate, fixed exchange rate, interest rate, foreign exchange reserves, capital outflow, capital inflow, import substitution, export orientation, purchasing power parity, exchange rate.

Introduction. There are various factors in the monetary sector that lead to inflationary processes. In such cases, the state assumes the main role, which rapidly reduces its growth by taking certain anti-inflationary actions. But as usual, the state, as a rule, pursues some of its own goals, let it be maintaining a high level of employment in the economy, the achievement of which leads to inflation to a side effect. Suppose the economy is at full employment, there is no inflation, and prices are stable and low. But the state, for example, wants to stimulate economic growth by increasing government spending. What will happen in the economy? Then, under the influence of additional government spending, aggregate demand increases with the inflow of additional money, firms feel an increase in purchases of goods and services and seek to expand production. Since the economy is at full employment, there are no free resources in the economy, and firms need to increase nominal wages to attract additional labor. Higher nominal wages will stimulate those people who previously did not want to work at low nominal wages to go to work. This means that previously voluntarily gave up labor, considering the current profitability of labor as low for them. Now they are more motivated to work, they find work, and as a result, in the short term, GDP increases. How, then, will the economy react in the long run if the state confines itself to one-time intervention? As we can see, there are no real changes in the economy associated with the appearance of additional resources or an increase in labor and capital productivity. Economic growth is due to the infusion of public money and the money illusion of workers: individuals take changes in nominal values for a change in the real situation. The extra money and the rise in nominal wages cause the prices of goods and services to rise. As workers begin to realize that their real wages have not changed, and firms are forced to pass higher nominal costs to consumers in the form of price increases, the short-run aggregate supply line begins to shift upward from AS_3 to AS_1 [13].

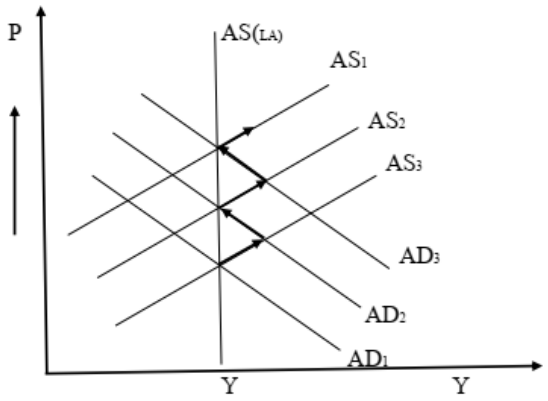


Figure: 1. Inflation as a result of chronic government budget deficits.

The economy returns to its potential output (Y), but at higher prices. There has been a rise in prices, but this growth is one-off, it is not inflation. This is called the price adjustment of the economy to the new situation, to new additional money [13].

It is known from this that the economic problem, the stimulation of economic growth as such, was not solved by the state. The economy returned to its original level, which was regarded by the state as too low. In this case, the state will want to solve this problem in the next period. New injections of public money will be undertaken - and again with the same success. Long-term active social policy of the state is usually the emergence and maintenance of the state budget deficit. When the deficit is small, the missing amount can be taken by issuing government short-term bonds[4].

The increase in the size of the deficit creates difficulties in non-inflationary financing. It is more difficult to find economic agents willing to purchase government bonds. If such a policy continues for many years, the inevitable result is the monetary coverage of the state budget by printing money from the Central Bank. The economy finds itself drawn into an inflationary spiral: stimulating aggregate demand - rising prices - rising production costs - reducing aggregate supply - stimulating aggregate demand again. The arrows to the right of the potential output line (aggregate supply in the long run) in Fig. 1. shows the development of an inflationary spiral of this type [13].

The question is how you can still finance the public debt? The budget surplus exerts the maximum restraining effect on aggregate demand when it is completely withdrawn and "frozen". The stabilizing effect of the budget surplus is weakened when it is partially or fully used to pay interest on government debt, increase social transfers, or finance any government programs. Since the growth of the cyclical surplus occurs during the period of economic recovery, any payments to the population of part or the full amount of these funds will further increase total spending and "accelerate" inflation in demand [5]. On the contrary, a complete withdrawal of the budget surplus limits the expansion of aggregate demand and curbs inflation. The consequences of the stabilizing effect of the budget deficit depend on the way it is financed [18]. Let's consider these five ways.

Methods and materials. The first way. Issue financing. The monetization of the budget deficit of the state budget consists in the fact that the state conducts money emission to cover the excess of state expenditures over revenues. In this case, seigniorage is formed - the state's income from monetary emission, which the state receives through the inflation tax mechanism. The increase in the money supply in the economy, other things being equal, leads to inflation, which, in turn, reduces the purchasing power of money[6]. The losses of economic agents from the depreciation of money are called inflation tax, through which part of their income is redistributed in favor of the state. With emission financing, the state budget deficit and the general instability of the financial system can grow. This happens in an environment of rising inflation, when taxpayers deliberately delay the payment of taxes to the state budget. This behavior of taxpayers is stimulated by the acceleration of inflation, since the economic agent that protracts tax payments wins by making tax payments with depreciated money. Thus, the emission financing of the deficit, the positive aspect of which is efficiency, since in this case there is no need for lengthy approvals and discussions in parliament, has a significant drawback - inflationary consequences [9].

The second way. Sale of assets. The sale of land, public sector enterprises (privatization), gold, etc. can serve as a source of additional income for the state. are an example of such financing of budget deficits [17]. The sale of state assets is rarely resorted to, since they are not unlimited and can be exhausted.

The third way. Increase in tax revenues to the budget due to the growth of autonomous taxes and changes in tax rates. Financing the budget deficit by increasing autonomous taxes is an unsuitable way, the budget deficit in this case will decrease, but by a smaller amount compared to the amount of the increase in tax payments [16].

The increase in tax rates reduces the budget deficit, but as a source of replenishment of government revenues is limited in accordance with the pattern, which is reflected graphically by the so-called "Laffer curve". A. Laffer believed that as the tax rate increases from zero to one (from 0 to 100%), tax revenues first increase and reach a maximum at some value t = t *, and then fall, despite its further growth. According to Laffer, the fall in tax revenues at t> t * is due to the fact that higher rates inhibit economic activity (investment decreases, consumption decreases, etc.). This leads to a decrease in the tax base; therefore, even with an increase in the tax rate, tax revenues fall (Fig. 2). Tax evasion also plays a significant role as tax rates rise.

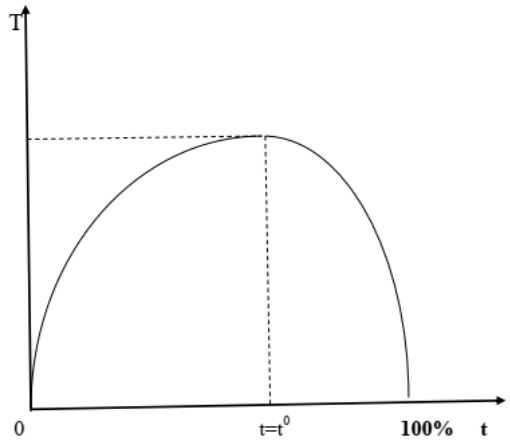


Figure: 2. Laffer curve

Thus, increasing taxes does not always solve the problem of budget deficits [13].

The fourth way. Debt financing of the budget deficit. In debt financing, the government, usually through the intermediary of the central bank, places government bonds on the domestic financial market. The proceeds from the sale are used to finance the budget deficit [13].

This method of financing the budget deficit is accompanied by a crowding-out effect. To explain this phenomenon, we will use the borrowed funds market model. In a closed economy, the supply of borrowed funds is formed at the expense of national savings as the sum of private and public savings. Hence, it is clear that the main factor determining national savings is total income. The demand for borrowed funds is created by economic agents in need of funds to finance their investment costs, and is determined by the interest rate, which is a payment for the use of borrowed funds. The interest rate balances the market for borrowed funds (Fig. 3).

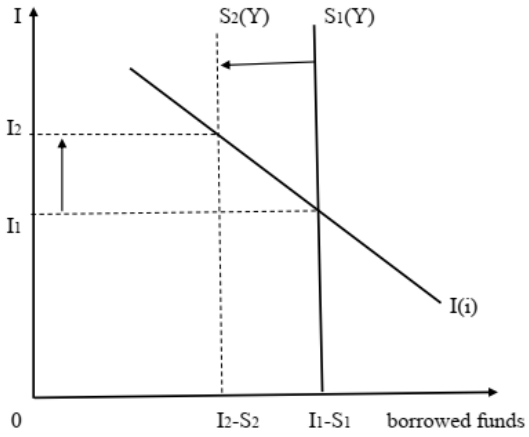
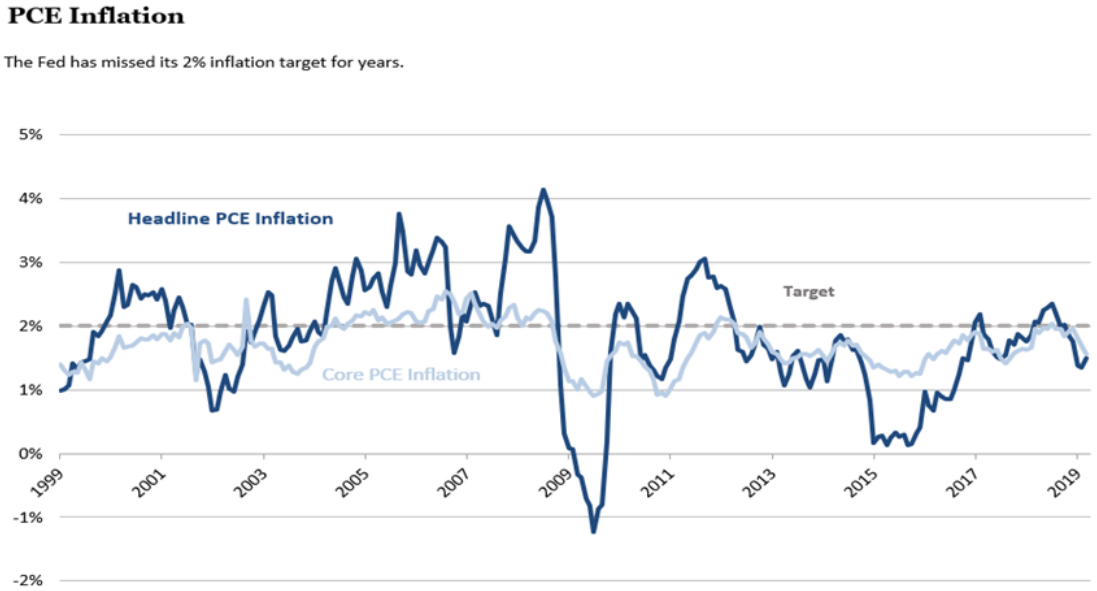


Figure: 3. Consequences of debt financing of the budget deficit in the debt market

Figure 3. Financing the budget deficit through borrowing from the private sector leads to a reduction in national savings, since, with private savings unchanged, government savings fall by the amount of the budget deficit (part of household savings is used not to buy securities of private firms, but to buy government securities papers) [13]. At the initial interest rate, investment demand will exceed national savings, leading to an increase in the interest rate and a reduction in investment. Consequently, when the government resorts to borrowing from the private sector to cover the budget deficit, investment activity in the economy decreases. Reducing investment spending in the private sector, as well as rate-sensitive consumer spending in debt financing of the budget deficit, is called the crowding-out effect, which significantly weakens the stimulating effect of fiscal policy[20].

The fifth way. Inflation target. The question of how inflation target affects price changes is considered. The Federal Reserve is charged by Congress with maintaining price stability and maximum sustainable employment. The Federal Reserve defines “price stability” as inflation at 2 percent [22]. Of course, this is the situation in developed countries. Yet in developing countries it looks different.

1.Table. PCE Inflation



Source: Haver analytics

By limiting or expanding the ability of the banking system to inject money into the economy. This is called the money transmission mechanism. It shows how the supply of money affects the situation in the market for goods and services.

It happens something like this:

1. The Central Bank changes the amount of money supply.
2. As a result, the rate of interest in the money market changes.
3. There is a reaction of aggregate expenditures.
4. In response to this, prices and production volumes in the real sector change.

All types of expenses react to changes in interest rates. With its growth, business entities reduce investments, and when money “cheapens”, they increase it. Households that use a consumer loan reduce consumer spending when it rises, and when it goes down, they increase it. Foreign partners also react when the Central Bank raises the interest rate. This leads to an inflow of foreign capital, mainly short-term, and predetermines the growth of the national currency. Accordingly, exports fall and imports increase. A decrease in interest rates triggers the opposite process: foreign capital, focused on obtaining quick income, leaves the country, the exchange rate of the national currency depreciates. This stimulates exports and restricts the more expensive imports. Prices in this mode react to changes in demand due to changes in the supply of money. If the demand of all participants in economic activity is constrained, then the rise in prices should slow down, because the ability to sell goods and services is limited. And curbing the rise in prices is the goal of inflation targeting. Inflation targeting instruments are the central bank's interest rate on short-term loans (one day, weekly, monthly) provided to commercial banks. When the refinancing rate rises, commercial banks lend to clients at higher rates and reduce the demand for loans from the Central Bank, trying to attract money from the interbank market. The amount of money in the market is shrinking, interest rates for the real sector are increasing, the population and business are reducing the demand for credit resources and their expenses. Aggregate demand is falling and price increases are slowing down. Not all banks apply to the Central Bank for credit resources, therefore, the required reserve ratio (reserve requirements) can be considered an additional inflation targeting tool. This is the minimum amount of cash cash reserves that banks must constantly keep in the form of deposits in reserve accounts with the Central Bank as security for their obligations. When standards grow, commercial banks have less funds to lend to the real sector, because of this, interest rates on loans rise, costs of the real sector decrease, which slows down the rise in prices. In countries where the market for short-term government securities is developed, the Central Bank's purchase and sale operations - the so-called operations on the open market - can also be a tool to influence interest rates. When government securities are sold, funds are directly withdrawn from the financial market, which causes an increase in interest rates on loans with the same consequences as described above for other instruments. Its supporters see the advantages of the inflation targeting regime in the following:

1. Evaluation of the success of monetary policy is simplified. The set of benchmarks of the Central Bank (the volume of money supply, the exchange rate of the national currency, the size of the net capital inflow, etc.) is replaced by one, which is a synthesis of many macroeconomic factors - the price growth index.
2. Greater freedom and flexibility for the actions of the Central Bank - it is not obliged to immediately respond to changes in the exchange rate or balance of payments. The Central Bank promised only that "inflation will not exceed the forecast level," and other indicators are the result of the interaction of many market forces.
3. The negative impact of "rational expectations" on the performance of the monetary policy is reduced. For example, the Central Bank is seeking to lower the exchange rate of the national currency in order to restrict imports and stimulate exports, and for this has been buying up foreign currency for some time. The population and business, realizing that imported goods will rise in price, are trying to buy them now, for which they increase the demand for foreign currency. As a result, in the short term, there is not a reduction, but an increase in imports, and the rate of the national currency depreciates in a "jerk", because everyone expects it to fall. Inflation targeting does not advertise either the instruments or specific points of application of the Central Bank's efforts, this reduces the ability of market agents to "play ahead" and reduce the effectiveness of policy.
4. The stabilization of inflationary expectations. If "everyone knows" that prices will rise, but they don't know how much, each seller tries to raise prices as much as possible today. However, not all sellers can sell their goods or services at the price they are asking for. Instability appears in the economy, hampering long-term planning, investment and innovation activities. The Central Bank's statement that it will not "release" inflation from the forecast framework increases the certainty and incentives for long-term (and therefore, first of all, to production, not speculative) economic activity.

Results. None of the above methods are perfect. Considering the same as targeting, it is also not a way out of the problem. Inflation targeting is effective only if the rise in prices is caused by monetary factors, that is, its reasons can be eliminated by measures of monetary policy. But when price increases are driven by external factors, inflation targeting does not work [21].

External factors include:

1. The rise in prices for important for the economy imported goods and raw materials (metals, oil products, wood, etc.), causing an increase in the price level within the country (imported inflation) [21].
2. The low level of competition, when a significant number of prices are set by monopolists. Consumers cannot refuse to buy goods and services of monopolists (be it natural gas, sugar or cars) because they cannot find a replacement for them. This allows you to keep monopoly prices at the border of solvency and increase them without fear of outflow of consumers [21].
3. The state regulation of a significant part of prices and tariffs or prices important for the economy [21].
4. The adverse weather conditions in agriculture or other external adverse events. If prices for agricultural products rise due to poor harvests, they cannot be contained by monetary policy measures [21].
5. The desire of the authorities to implement certain programs and finance expenses, regardless of the availability of sources of funds. If tight monetary policy is not accompanied by a reduction and optimization of government spending, then inflation targeting is useless. And the Central Bank is not authorized to carry out budgetary policy[21].

Due to a slowdown in the growth of aggregate expenditures, economic growth may also slow down, and due to their reduction, production and employment may decrease. At the same time, in the eyes of the public, inflation targeting will be "to blame", because these difficulties arose after its introduction [21].

To effectively use the inflation targeting regime, business and society must have confidence in the policy of the Central Bank, in its ability to implement the stated policy and achieve its goals. This implies transparency and openness of the Central Bank's activities. Inflation can be reduced by implementing tight monetary policy. It is important to choose the right measure of this tightening so that the short-term negative impact of a decrease in the money supply on the real and financial sectors is not excessive. But a period of high inflation is definitely not the time to implement any kind of stimulating policy that leads to an increase in the amount of money in circulation. Inflation targeting makes sense only when the inflation problem really requires a priority solution. If we consider the long-term consequences of debt financing in terms of the impact on economic potential, then the reduction in investment negatively affects the productive capacity of the economy and, thus, on the well-being of future generations [7]. Debt financing can also be carried out with the help of external borrowings, as a rule, in the form of loans from foreign states or international financial organizations, as well as by placing government bonds in foreign markets. The total amount of outstanding government obligations (external and internal) constitutes government debt. If the possibilities of financing the budget deficit by non-debt means have been exhausted, then the public debt grows annually by the amount of the current year's deficit [3]. Therefore, public debt can be defined as the accumulated amount of budget deficits. It is known that inflation is one of the results of the depreciation of the national currency. But according to the course of economic theory, it is known that the depreciation of the national currency is not yet an evil for the economy as a whole. It is known that depreciation, that is, devaluation, is one of the main key points in the expansion of world trade. The issue of monetary policy considers not only the

decrease in inflation, but also the increase in exports. It is worth discussing the issue of eliminating inflation through monetary policy.

Discussion. If of the above methods have both positive and imperfect sides, then one should consider the question of whether the exchange rate affects the economy? The value of the exchange rate and its change have a very large impact on the economy of any country that participates in international trade.

Monetary policy is a part of foreign economic policy and at the same time an integral part of monetary policy. Its main spheres are considered exchange rate formation, currency regulation, participation in the international monetary system. The exchange rate allows us to estimate the value of our national goods in foreign money, and to translate the prices of foreign goods into the national currency [11]. The increase in the international value of the national monetary unit (the fall in the exchange rate) is accompanied by a decrease in the cost of foreign goods for us and an increase in the cost of our goods for foreigners. The decrease in the international value of our money (increase in the exchange rate) means that foreign goods are becoming more expensive for us, and our goods for residents of other countries will now cost less than before.

If foreign goods for citizens of a country become cheaper due to changes in the exchange rate, its consumers will want to buy more of them. The import of foreign goods to this country will increase. At the same time, national goods will be more expensive for foreign buyers, they will be ordered in smaller volumes, and the export of national goods to other countries will decrease [19].

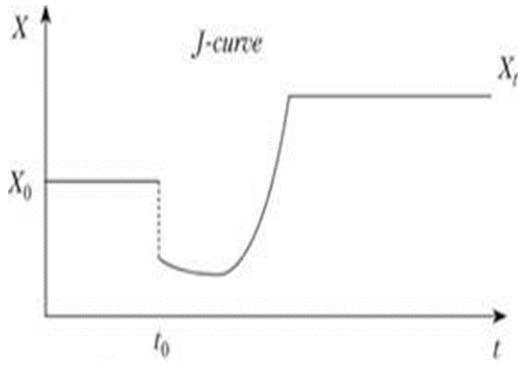
When a change in the exchange rate leads to an increase in the cost of foreign goods, consumers reduce demand for them, imports fall. A simultaneous reduction in the cost of national goods in the markets of other countries will lead to an increase in foreign demand and export of the country.

Suppose the state wants to stimulate the national economy by devaluing the national currency. From tomorrow, let's say the Central Bank sets a lower exchange rate for the national currency. Does this mean an automatic and unconditional expansion of net exports (decrease in imports and increase in exports) for the country?

Consider the export situation. On the one hand, the depreciation of the national currency means that exports to foreign companies are now cheaper, foreign firms can spend less of their own monetary units to purchase the same product. However, in the modern world, production is rarely done on the principle of instant purchase. Export contracts are discussed for a long time and are concluded for quite long periods. Therefore, even if the unit price of export has decreased, the volume of export purchases cannot be immediately increased due to the validity of contracts. Only when the term of the contract comes to an end, foreign firms can decide to expand export volumes [15]. On the other hand, even if we imagine an ideal economy in which contracts can be renegotiated at any given time, there is still a production side. Domestic manufacturers that produce products for export will not be able to increase production overnight, even with a very significant increase in demand for their products. Building a plant, hiring personnel, and preparing export documentation - all this requires a certain, sometimes significant, time.

Now let's see how things stand with imports. On the one hand, there are also favorable opportunities for the country. The depreciation of the national currency means a rise in the cost of imports. But imports are also a result of both prices and volumes. When the price of imports rises for national consumers, the dynamics of the volume of imports depends on the reaction of buyers. Imports may not decline or only slightly decline in the case when the price elasticity of domestic demand for imported products is low (imports are price inelastic). In addition, since the imported goods and services satisfied some need of domestic consumers, this need will still exist [13].

The speed of import substitution plays an important role here: to what extent can domestic products satisfy the same needs of individuals and firms; how quickly domestic manufacturers will be able to master or increase the production of replacement products. Thus, although in the long term there will be an effect of an increase in net exports (decrease in imports and an increase in exports) under the influence of a decrease in the value of the national currency, in the short term, a currency depreciation may be accompanied by a drop in exports and net exports [13].



t_0 depreciated currency

Figure. 4. Export and Net Export Trajectory Driven by Depreciation of the National Currency

The export function is $X = X_0 + h_1 E,$

where X_0 - autonomous export, does not depend on events within the country, is determined by income in countries that buy the products of this economy; h_1 is the currency elasticity of exports; E - exchange rate[13].

If economic agents consider the change in the exchange rate as a temporary phenomenon, then exporters will reduce national prices and exports will not change. If agents consider such rate dynamics as a constant phenomenon, then exports will decline.

The import function is $Im = zY - h_2 E,$

where z is the marginal propensity to import; h_2 is the currency elasticity of imports. With the strengthening of the national currency, imported goods become cheaper relative to domestic products, and imports grow [13].

The net export function is $NX = X - Im = X_0 - zY + hE,$

Let's turn to the impact of the exchange rate on a country's economy and then to its monetary policy [13]. On the balance of payments, the impact of the exchange rate is carried out primarily through the trade balance. Imports are stimulated by revaluation and hindered by devaluation. This is because, in the first case, domestic prices for imports fall and demand for them grows. However, the rise or fall of imports largely depends on the price elasticity of demand for imports, more precisely, for each product of these imports.

With exports, the opposite happens - with devaluation, it becomes more profitable for exporters, and with revaluation, it becomes less profitable. For the state budget (more precisely, for state revenues), much depends on how the change in the exchange rate affects the receipt of taxes, including customs duties. Exchange rate fluctuations have a significant impact on inflation. Foreign goods in many developing countries account for more than 40% of retail goods, and their price in local currency depends on the exchange rate of the national currency. Therefore, a weak national currency significantly stimulates inflation, while a strong national currency significantly counteracts it. Let us first turn to the policy in the field of exchange rate formation (exchange rate policy). With a floating rate, it is established under the influence of supply and demand and, ideally, should be in equilibrium (by analogy with the equilibrium price, because the exchange rate is the price of a currency). However, deviations from the equilibrium exchange rate often occur, and especially in less developed countries, where the market mechanism of exchange rate formation is often weak. It is clear that the state in these countries is actively using the exchange rate (primarily by lowering it) to boost economic development through foreign exchange incentives for exports. To a lesser extent, the state interferes in the exchange rate formation in developed countries, however, even there it is forced to do this with a large scale of speculative currency transactions, which can lead to too sharp fluctuations in the exchange rate. For most developing countries, the picture is almost the same: the country has a large positive balance of payments, but the rates of economic growth are insufficient, unemployment is high even in the years of recovery, and inflation, although it is decreasing, remains at a high level. For Neokeynesians, the point of view is that such developing countries need a strong national currency that will prevent the outflow of domestic capital, facilitate the inflow of foreign capital, repay external debt and import investment goods, and reduce inflation, which ultimately will have a beneficial effect on economic growth [7]. However, with this approach, it remains unclear how profitable is from a strong national currency when it will discourage exports. Neoliberals believe that a weak exchange rate of the national currency is needed, which will stimulate economic growth through increasing exports and curbing imports. They argue that it is the weakening of the national currency that will increase the competitiveness of the economy[4].

Although this approach favors inflation, neoliberals offer inflation targeting to developing countries to reduce it [18].

The Central Banks in this discussion takes a neutral position, pushing the problem of exchange rate formation to the background, highlighting inflation targeting, in which it ceases to actively intervene in exchange rate formation, except in cases of very sharp exchange rate fluctuations [21]. "The implementation of monetary policy will take place in a flexible exchange rate environment. At the same time, the Central Bank will maintain its presence in the foreign exchange market solely for the purpose of smoothing excess exchange rate volatility, without influencing trends in its dynamics, formed by fundamental factors. This will allow avoiding risks to the stability of the financial system due to excessively sharp fluctuations in the exchange rate and at the same time will help the adaptation of economic agents to work in the conditions of an almost freely floating exchange rate. A consistent reduction in the direct intervention of the Central Bank in the exchange rate formation processes means a decrease in the influence of foreign exchange purchase and sale operations in the domestic market on the formation of banking sector liquidity [21]. In this regard, the policy of managing interest rates becomes key in the process of monetary regulation. The Central Bank can use the short-term interest rate of the interbank market as an operational benchmark for interest rate policy [21].

State intervention in the exchange rate setting at a floating rate is carried out mainly through foreign exchange interventions, i.e. purchase and sale of currency by the state in the foreign exchange market. In case of an increase in the exchange rate of the national currency, which is undesirable from the point of view of the state, the central

bank artificially reduces the supply of foreign currency in the foreign exchange market, actively buying this currency into its reserve assets [21]. With an undesirable drop in the national currency rate, the central bank artificially increases the demand for it, for which it begins to actively buy up the national currency in the foreign exchange market, spending reserve assets on it. At the same time, the state needs to solve at least two questions - when to intervene in the exchange rate formation and whether reserve assets are sufficient for this.

With regard to currency regulation, this is the activity of the state but the regulation of operations with currency, carried out on the basis of currency legislation. In countries with freely convertible currencies, this legislation contains few restrictions on currency transactions - mainly, these are requirements to provide statistical reporting, bans on money laundering through foreign exchange transactions and restrictions on transactions with certain countries [8]. In countries with limited convertible currencies, restrictions on foreign exchange transactions are much greater - ranging from the requirement for mandatory repatriation of export earnings to the country and ending with the need to obtain permits to exchange national currency for foreign currency for most balance of payments transactions. As a result, currency control becomes inevitable, i.e. control over observance of currency restrictions [2].

Nevertheless, one question is asked with all this: what kind of adequate monetary policy are the countries with high GDP pursuing? It is worth citing China's monetary policy as an example [14].

Currency War: Chinese Yuan and American Dollar.

In October 2010, the "financial seven" (G-7) met in Washington. One main issue was discussed - how to prevent a "currency war" (this term was first used by Brazilian Finance Minister Guido Mantega). Its essence is that the leading countries of the world are seeking to pursue a policy of undervaluation of their currencies in the struggle to expand export markets for their goods. It should be noted that the "currency war" pursues the same goals as protectionism, but moves towards these goals from the other side. Let us recall that protectionism is protection from imports through higher duties and other restrictions. "Currency war" is the state's support for exports through the undervaluation of the currency of the exporting country. The goals in both cases are the same - the desire to expand the opportunities for demand for the products of their producers through import substitution (in the case of protectionism) and to increase exports abroad in the event of a "currency war". In 2010, the United States, Japan, South Korea, and Taiwan resorted to foreign exchange interventions (i.e., the massive injection of the national currency into the market in order to weaken it - to devalue it). But China is using China's policy of "weak" currency really effectively in the long run [14]. A "weak" currency in this context has the meaning that it is very "lightweight" in comparison with its real value and in relation to other currencies. The US and the EU have been criticizing China for "currency expansion" for several years now, insisting that the yuan's exchange rate be increased (revalued) [14]. The Chinese authorities have partially yielded to these demands, "easing" the yuan's exchange rate, but not enough to appease the United States. Beijing, undoubtedly, deliberately does not implement the convertibility of the yuan, since then it will be regulated by the actions of market forces in the financial and foreign exchange markets, while non-convertible currencies are in the sphere of direct state financial and economic policy. Therefore, it is no coincidence that many analysts believe that the low (undervalued) yuan exchange rate is one of the main elements of the Chinese economic miracle. It is also interesting that the term "currency war", firstly, came into being after its result was China's ascent to the pedestal of the second industrial power in the world; and secondly, representatives of the official authorities of leading countries are afraid to accuse China of a "currency war." Thus, during the above-mentioned October meeting of the "financial seven", all the participants were careful not to associate China with the repeated phrase "currency war". However, the well-known financial player George Soros said in those days that at present "a special situation has been created in the world economy, when China actually controls the world monetary system [14]."

This, of course, is not entirely true, since the main responsibility for the state of the global currency market lies with the Fed and the ECB, as well as the Bank of England and the Bank of Japan. Their rates are the main regulators of the world economy. However, according to Soros, "this scheme is already outdated." The problem is not only in the non-convertible yuan, but mainly in the fact that, with its huge international reserves (over $ 3 trillion in the first quarter of 2011), when placing them, Beijing is now guided exclusively by its own political interests. Thus, right up to the global crisis, China and the United States had a consensus: China's huge surplus in bilateral trade was offset by the placement of Chinese dollars in US securities. But now China has moved away from this rule and increasingly moves its foreign exchange reserves in euros, which caused the euro to rise against the dollar in autumn 2010. This has demonstrated the real power of China, which can significantly influence the global economic situation [14].

Obviously, this situation creates large imbalances in the world economy. It is also clear that these imbalances can be largely resolved by increasing US exports to China, but for this it is necessary to revalue the yuan and, no less important, to significantly expand China's domestic demand. From our point of view, it is senseless to demand from the Chinese leadership to drastically "ease" the yuan, since this not only cannot give a positive result, but is fraught with serious negative consequences if the Chinese leadership decided to take this measure. It is necessary to take into account the interests of this country - any "failure" in its development will not only not improve the world financial stability, but rather aggravate it, therefore, China should not be blamed for "expansion" or other

troubles of the world economy. The problems in the world economy were created not in Beijing, but in London, Tokyo and other world financial centers, and not in recent years, but in the 1980s-1990s, when the financial market element was deliberately "launched" by the liberalization policy of these countries under dictation by powerful TNCs and TNBs. [14]. Now the whole world is reaping the fruits of the then reigning confidence in these countries in the magical power of the market, subject to the global flows of transnational capital for enrichment [14].

Conclusion. Thus, considering the process of influence of monetary policy to eliminate inflationary processes in the economies of developing countries, the following conclusions should be drawn. First, in economic analysis, one should proceed from the situation in which period of time it should be considered. As you can see from the second part of the article, the economy usually shows positive results in the short term. But, however, macroeconomic stability needs to be considered in the long term. In this regard, we can say that not every financial instrument is effective in the long term. The second question that was considered is which financial instrument, or which macroeconomic policy in developing countries is more effective in the long run if it pursues the elimination of inflationary processes. Here, the answer was received that in most cases developing countries pursue inflation targeting policies. By limiting or expanding the ability of the banking system to inject money into the economy. This is called the money transmission mechanism. It shows how the supply of money affects the situation in the market for goods and services. Inflation targeting is not effective if the rise in prices is caused by external factors, then in this case it does not work. Thirdly, we considered the issue of monetary policy, how it effectively affects the country's economy, that is, even if, for example, the depreciation of the national currency, which is the result of inflation, how can it further affect the inflow of capital, thereby improving the balance of payments. We came to the next conclusion that moderate inflation is not a problem yet. It, in turn, depreciating the national currency, has a positive effect on the export of products. Namely, adhering to such a monetary policy in the long term, China was able to reach a high level of development by increasing the annual production of goods and services. It should be noted that China took advantage (still uses) not only the cheapness of the national currency, thereby improving the rapid growth of exports of goods and services, but also attaches particular importance to the increase in the production of goods and services at the same time. The depreciation of the national currency is accompanied by an increase in the growth rate of the production of goods and services. Many developing countries make a mistake on this very issue. It is the growth of production that should ensure the corresponding export, which is supported by currency devaluation. The exports are the main source of capital inflows. The capital inflows should increase investment, production. An increase in production also means an increase in supply. Everyone knows that when the supply increases, the price goes down. A decrease in the price of itself means a decrease in inflation. You can see it on the chart. A shift in the supply curve to the left S_1 means an increase in supply, a decrease in prices[13].

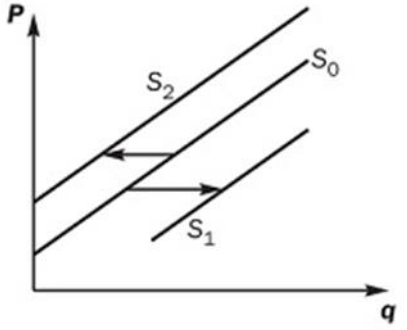


Figure: 5. Shift of the supply curve.

Following from these considerations, a fourth conclusion is made that only an increase in production can naturally reduce inflation and have a beneficial effect in the long term on the economic growth of the developing countries of the world [13]. A decrease in the rate of price growth will lead to an increase in the well-being of the population, not only because expenses will not grow rapidly, but also because the possibility of earning income will increase. Fifth**,** when adopting one or another economic policy, it is always recommended to consider in the future all goals and objectives only in the long term. Sixth, in order to support the economy with a high level of production, loans should be issued on market conditions, abandoning concessional loans that are issued to "special" entrepreneurs. providing soft loans creates unequal conditions for doing business, contributes to the destruction of the competitive environment. After all, enterprises that receive loans on preferential terms have competitive advantages over enterprises that are forced to pay very high interest rates for loans, or are forced to abandon lending, because they cannot afford such expensive loans. As a result, the advantages in the market are not competitive.

As a result, everyone suffers, except for the recipients of preferential loans: [25].

· The entire population and business - due to high inflation;

· Consumers forced to buy expensive and low-quality goods from non-competitive manufacturers;

· Employees - due to the low competitiveness of our enterprises, the demand for labor and the wages offered in the market are low;
· Private entrepreneurs who do not have the opportunity to develop their business because of expensive loans;
· The state that receives less taxes from the non-competitiveness of the economy and spends budget funds to subsidize inefficient enterprises.

The only way to curb inflation is to create a level playing field for business, eliminate monopoly power in the market, and lower the market interest rate. It is necessary to start the processes of restructuring and privatization of state-owned banks [25]. The privatization of state-owned commercial banks will simultaneously develop competition in the banking sector and replenish the budget. Provided, of course, that it will not be privatization "for our own"[25]. The Central bank needs to continue banking reform towards fostering competition in the sector and ensuring greater transparency in its work. In particular, it is necessary to create conditions for access to the sector for new players, including foreign financial organizations.

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