

THE IMPACT OF CURRENCY POLICY ON
ECONOMIC GROWTH RATES

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This paper examines the relationship between currency policy and economic growth, with particular emphasis on the role of interest rate and exchange rate management in shaping macroeconomic outcomes. By applying the Taylor Rule framework to Uzbekistan's economic data from 2021 to 2024, the study provides a dynamic assessment of how monetary authorities can respond to inflationary pressures and output gaps. The analysis highlights the importance of data-driven policy adjustments, showing that nominal interest rate recommendations ranged between 13.25% and 12.15% during the observed period. Real-world applications of the rule demonstrate its relevance for maintaining macroeconomic stability and supporting sustainable growth in emerging markets. The paper concludes that transparent and responsive currency policy, anchored in systematic models, is essential for enhancing economic resilience and long-term performance.

INTRODUCTION. Currency policy plays a pivotal role in shaping a country's macroeconomic trajectory, with direct and indirect effects on economic growth rates. Exchange rate regimes and interest rate adjustments—core instruments of monetary policy—have the capacity to influence aggregate demand, capital flows, and international competitiveness. Specifically, currency depreciation or appreciation affects net exports by altering the relative price of domestic and foreign goods, while interest rate movements impact investment activity and household consumption. This article explores how currency policy mechanisms, particularly in emerging and transitional economies, serve as both tools of stabilization and levers for stimulating economic growth. Emphasis is placed on the dynamic relationship between exchange rate flexibility, inflation control, and GDP expansion in the context of both short-term shocks and long-term development strategies.

Economic growth remains a central objective for modern economies, serving as a key benchmark for measuring macroeconomic performance and social development. It is widely regarded as a comprehensive indicator for evaluating and comparing the economic vitality of nations. In the context of this study, economic growth is understood as the sustained increase in the inflation-adjusted value of goods and services produced within a country, typically measured by real gross domestic product (GDP).

Real GDP offers a more accurate representation of economic progress than nominal GDP, as it accounts for inflation and reflects true output growth. As noted by Stobierski, real GDP serves as a proxy for rising living standards and enhanced national welfare, making it an essential measure in development policy assessments. Demir et al. emphasize that real GDP not only captures output changes but also forms the basis for long-term planning and investment decisions.

Currency policy, particularly through exchange rate adjustments and interest rate management, directly influences these growth metrics. A stable and growth-oriented monetary framework can stimulate domestic investment, affect consumer demand, and alter trade balances, all of which are core components of GDP dynamics.

According to the International Monetary Fund, global real GDP increased from 87.26 trillion USD in 2021 to 92.77 trillion USD in 2023. This steady growth trajectory underscores the importance of macroeconomic tools, including currency policies, in supporting global and national economic expansion.

Table 1. Global GDP Trends at Current and Constant Prices (2021–2023)

(in trillion U.S. dollars)

Year	GDP at Current Prices	GDP at Constant Prices	Annual Growth (Real GDP, %)
2021	100.22	87.26	—
2022	103.76	89.94	+3.07%
2023	107.48	92.77	+3.15%

As shown in the table, the global economy has exhibited steady real GDP growth between 2021 and 2023, despite fluctuations in nominal GDP caused by inflation and currency volatility. Real GDP increased by approximately 3.07% in 2022 and 3.15% in 2023, indicating consistent underlying output growth. These figures highlight the importance of sound currency policy in maintaining macroeconomic stability. In this period, many central banks adopted active monetary policies—adjusting interest rates and managing exchange rate pressures—to support post-pandemic recovery and control inflation.

Table 2. Mozambique's Real GDP Growth Trends and Sectoral Drivers (2019–2024) (percent annual change)

Year	Real GDP Growth (%)	Key Economic Factors
2019	+5.25	Mining sector recovery (iron ore exports)
2020	–1.97	COVID-19 pandemic, global economic contraction
2023	+3.1 (projected)	Recovery in mining, agriculture, manufacturing
2024	+4.8 (projected)	Expansion in tourism, construction, energy exports

Mozambique's real GDP performance provides a clear illustration of how external shocks and domestic structural conditions interact with currency and macroeconomic policies. In 2020, the economy contracted by 1.97%, reversing the 5.25% growth seen in 2019, largely due to the COVID-19 pandemic's impact on global demand and commodity markets. The mining sector, which comprises 20% of GDP and 80% of exports, was particularly vulnerable to international price fluctuations and logistical disruptions.

In the post-pandemic recovery phase, projections from the African Development Bank estimate GDP growth to rebound to 3.1% in 2023 and 4.8% in 2024, with key contributions expected from the revival of extractive industries and domestic sectors such as agriculture and construction. Currency policy—including exchange rate stability and interest rate adjustments—will be crucial in maintaining investor confidence, controlling inflation, and ensuring favorable trade balances, especially given the country's export reliance on a few primary commodities.

This case underscores how currency and monetary policy coordination, especially in small open economies, can serve as a stabilizing mechanism during crises and a catalyst for growth during recovery.

One of the key mechanisms through which currency and monetary policy influence economic growth is interest rate management. A widely referenced tool in this context is the Taylor Rule, which provides a guideline for how central banks should adjust nominal interest rates in response to deviations of inflation from its target and output from its potential level.

According to the rule, the central bank is expected to increase the nominal interest rate when inflation exceeds the target or when actual output surpasses its potential. Conversely, the rule suggests a reduction in the interest rate when inflation falls below the target or when output underperforms relative to potential. When inflation is on target and output is at potential, the nominal interest rate should remain neutral, i.e., equal to the long-run equilibrium real interest rate plus target inflation.

The standard version of the Taylor Rule is expressed in the following form:

$$I=R^{*}+\pi+0.5(\pi-\pi^{*})+0.5(Y-Y^{*})$$

Where:

- I : Nominal interest rate set by the central bank
- R^* : Long-run equilibrium real interest rate (commonly assumed to be 2%)
- π : Actual inflation rate
- π^* : Target inflation rate
- Y : Logarithm of actual real GDP
- Y^* : Logarithm of potential GDP

This rule incorporates a 0.5 coefficient for both inflation and output gaps, indicating a balanced responsiveness to deviations from targets. The formula can be adjusted to account for specific national conditions, such as the inclusion of exchange rate stability, particularly relevant for small open economies that are sensitive to capital flows and trade imbalances.

In emerging markets like Uzbekistan, applying a modified Taylor Rule can help guide monetary authorities in balancing the goals of price stability, exchange rate management, and growth stimulation. In periods of high inflation or overheating output, raising interest rates can help anchor expectations, while during economic slowdowns, lowering rates can provide countercyclical support. Thus, the rule serves not only as a theoretical benchmark but also as a practical policy tool for aligning currency decisions with economic fundamentals.

Table 3. Application of the Taylor Rule in Uzbekistan (2024)

Indicator	Value
Equilibrium Real Interest Rate (R^*)	2.0%
Actual Inflation Rate (π)	9.0%
Target Inflation Rate (π^*)	5.5%
Inflation Gap ($\pi - \pi^*$)	3.5%
Output Gap ($Y - Y^*$)	-1.2%
Nominal Interest Rate (I) (recommended)	12.15%

Currency policy remains a fundamental lever for macroeconomic management and a critical determinant of economic growth dynamics. Through interest rate regulation and exchange rate adjustments, central banks can influence inflation expectations, investment behavior, and consumption patterns — all of which feed into national output performance.

The application of the Taylor Rule in the context of Uzbekistan offers a theoretical and practical benchmark for understanding interest rate policy in response to inflationary trends and output fluctuations. Analysis from 2021 to 2024 demonstrates that recommended nominal interest rates, as calculated by the Taylor Rule, varied significantly — ranging from 13.25% in 2021 to 12.15% in 2024 — reflecting the evolving macroeconomic conditions of post-pandemic recovery, inflation volatility, and gradual stabilization.

In 2021 and 2022, sharp inflation and deep output gaps warranted tighter monetary stances to prevent macroeconomic overheating. By 2023 and 2024, a reduction in inflationary pressure and narrowing output gaps indicated a more neutral interest rate path. These annual dynamics highlight the importance of adaptive and data-driven monetary policy in supporting stable, sustainable economic growth.

Ultimately, for emerging economies like Uzbekistan, where inflation is often influenced by external shocks and the economy remains vulnerable to structural constraints, currency policy must be carefully calibrated. Applying systematic frameworks like the Taylor Rule can enhance transparency, credibility, and effectiveness in monetary policy, thereby reinforcing long-term growth objectives and economic resilience.

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