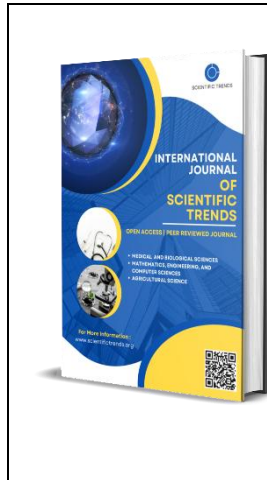


# The Impact of the Budget Deficit on the Effectiveness of Monetary Policy

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## Abstract

The interaction between fiscal and monetary policy is a central issue in both macroeconomic theory and policy. A budget deficit, especially when persistent, can affect the effectiveness of central bank instruments through several channels: pressure on interest rates, debt “monetization,” and impacts on the availability of financial resources within the economy.

This article aims to theoretically and empirically assess how and to what extent the budget deficit influences the effectiveness of monetary policy, to determine how these effects depend on institutional characteristics, and to provide practical recommendations for coordinating fiscal and monetary policies.

**Keywords:** State budget, monetary policy, inflation, GDP, public debt.

## Introduction

The state budget is a key instrument for implementing fiscal policy and serves as a crucial mechanism for ensuring macroeconomic stability. Its structure, volume, and allocation of expenditures reflect the priorities of the government’s economic policy and the extent of its involvement in regulating socio-economic processes. In the context of increasing global instability—caused by external economic shocks, changes in commodity markets, and the transformation of global value chains—the task of effective budget management acquires strategic importance.

While the primary goal of monetary policy is to maintain price stability, that is, consistently low inflation, for the Republic of Uzbekistan, which is undergoing extensive socio-economic reforms, the state budget becomes the foundation for sustainable economic growth, social protection, and financing structural modernization. Ensuring the balance of the budgetary system requires a systematic approach that includes both the optimization of tax and budgetary mechanisms and the enhancement of budget expenditure efficiency. Studying the role of the budget in achieving macroeconomic stability in Uzbekistan makes it possible to identify reserves and priority directions for fiscal policy in the near future.

## Methods

In examining the perspectives of both domestic and international scholars on the role of the state budget in ensuring macroeconomic stability, particular attention should be given to the work of A.A. Khranchenko and his colleagues. In their research, they emphasize that “in a market

economy, the state budget performs a strategic function within the mechanism of financial regulation for economic development. The effectiveness of budgetary influence is determined not only by the volume of financial resources but also by the extent to which the role of the budget as a tool for transforming socio-economic relations has been scientifically analyzed, as well as the alignment of the budgetary policy model with the current stage of socio-economic development of the country” [1]. According to these scholars, the budget, as the official financial plan of the state and local governments, constitutes a fundamental instrument for implementing fiscal policy, particularly amid deep institutional changes.

From our perspective, the effectiveness of budgetary policy largely depends on its adaptability to internal challenges and its capacity to integrate long-term sustainable development priorities into financial planning. This is particularly critical for transitional economies, where the state budget must not only perform redistributive functions but also stimulate structural transformations, innovation, and investment activity. T.Yu. Manzhula highlights that “the state budget is not merely a financial document but a reflection of a complex set of critical economic, social, and political issues affecting both society as a whole and individual citizens. The budget delineates the scope of government activity, demonstrating the state’s financial potential on the one hand, while imposing institutional constraints on the volume and direction of this activity on the other” [2].

Within a market economy, the state budget serves as a key regulator of macroeconomic and social processes. It functions as a principal instrument through which the government influences the distribution and redistribution of gross domestic product, ensuring the alignment of interests across regions, economic sectors, and social groups. This role becomes especially significant during periods of economic instability, when market mechanisms alone are insufficient to equalize disparities and provide social compensation. In such circumstances, targeted resource redistribution, determination of tax revenue volumes, and budgeting parameters are implemented through fiscal mechanisms, creating conditions for macroeconomic stability and enhancing the efficiency of fiscal policy.

Domestic expert Z.Kh. Sirojiddinova analyzed major reforms in Uzbekistan’s public finance management system since 2007. Key achievements include the establishment of the Treasury under the Ministry of Finance and the transition from a banking to a treasury model of budget execution, which increased transparency of fund flows and reduced arrears. The introduction of a Single Treasury Account and an integrated public finance management information system improved monitoring efficiency and the allocation of state resources. Additionally, a new accounting system and budget classification framework based on IMF standards were implemented, strengthening financial transparency and the stability of fiscal policy. Notably, the adoption of medium-term planning and a program-targeted approach to budgeting has been instrumental. Since 2002, oversight of public resource use has been conducted by an independent Audit Chamber accountable to both the President and Parliament, enhancing institutional guarantees for transparency and accountability in the budgeting process [3].

Uzbek researchers rightly emphasize the central role of the state budget as a core element of the country’s financial planning: “The budget functions not only as the primary financial document defining resource allocation strategies but also as the structural center of the entire financial system, concentrating and redistributing key state revenues, expenditures, and obligations. It

accumulates significant tax revenues, forming the largest centralized monetary fund through which economic and social policies are implemented” [4, 5].

We argue that the particular importance of the state budget lies in its dual function: it not only reflects the current financial condition of the state but also actively influences the country’s monetary and credit policy. Amid increasing external economic challenges, effective budgetary regulation becomes the foundation of a balanced and flexible financial policy. In summary, the reviewed literature demonstrates a broad consensus among scholars regarding the pivotal role of the state budget as a tool of financial regulation and strategic economic management. Beyond resource redistribution, the budget functions as a stabilizer, mitigating market fluctuations and supporting institutional transformations.

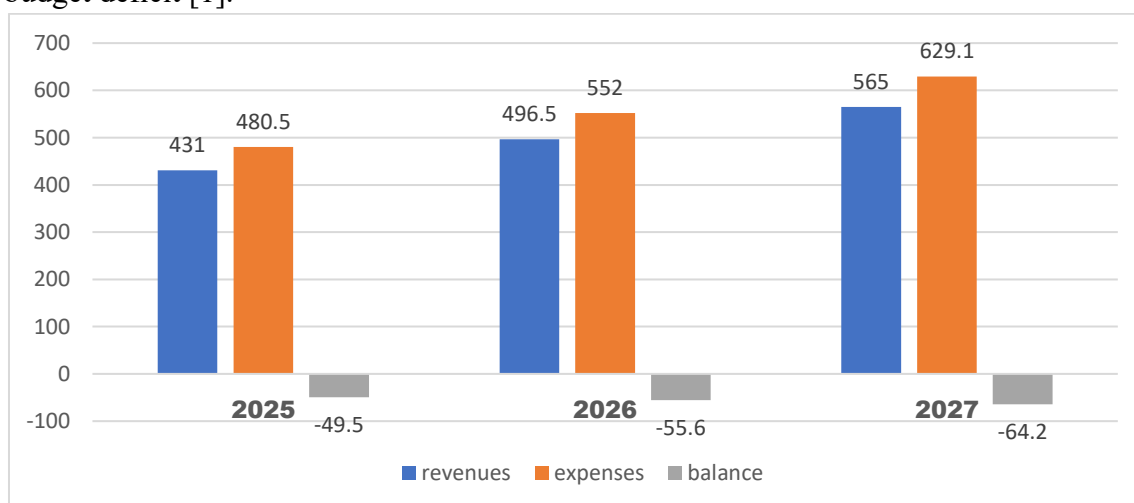
It is important to emphasize that, for the Republic of Uzbekistan, the state budget serves as the primary mechanism for maintaining macroeconomic stability. It enables the smoothing of fiscal and social imbalances, supports priority sectors, and lays the foundation for sustainable economic growth. The effectiveness of budgetary policy directly impacts financial stability, the investment climate, and the country’s long-term development.

## Results

Considering the theoretical approaches discussed, it can be concluded that the academic community unanimously recognizes the crucial role of the state budget as the primary instrument of macroeconomic regulation, ensuring stability and guiding socio-economic development.

In the context of the Republic of Uzbekistan, this issue acquires particular significance, as the country is undergoing a phase of active institutional reforms aimed at addressing regional and sectoral disparities and maintaining long-term macroeconomic stability. In this regard, conducting an analytical assessment of empirical data that reflects the extent of the state budget’s involvement in ensuring macroeconomic equilibrium becomes essential.

The projected dynamics of the consolidated budget of the Republic of Uzbekistan for 2025–2027 indicate a widening gap between revenues and expenditures. Despite a positive trend in revenue growth, government obligations are increasing at a faster pace, resulting in a gradual expansion of the budget deficit [1].

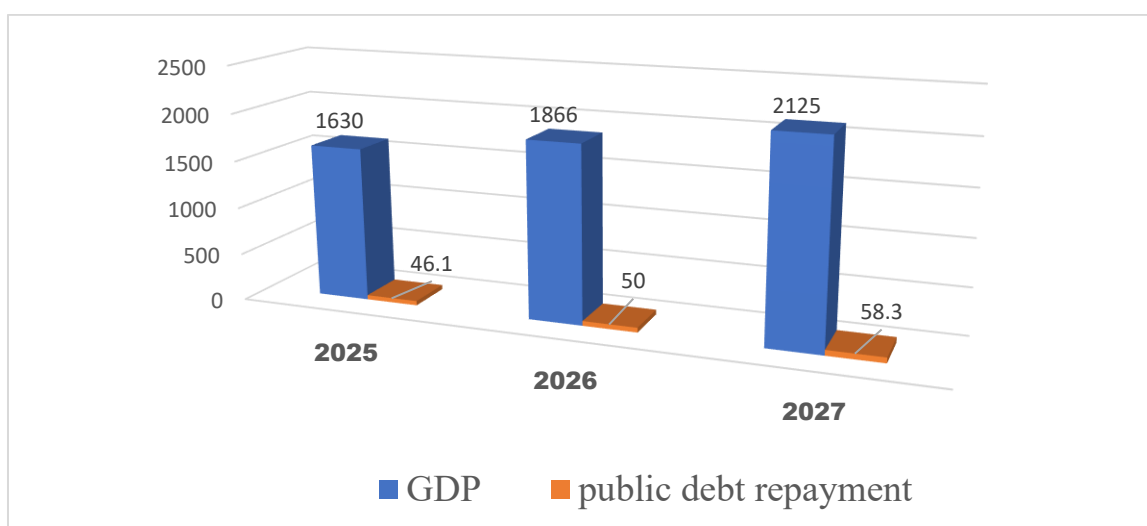


**Fig. 1. Forecasted parameters of the Consolidated Budget of the Republic of Uzbekistan for 2025–2027, trillion soms.**

The mismatch between revenues and expenditures in the state budget of Uzbekistan indicates the strain on current fiscal policy and underscores the need to reassess budgetary spending priorities, as well as to enhance the efficiency of financial resource allocation. The current budgetary dynamics reflect increasing pressure on fiscal sustainability and call for a balanced budgetary policy capable of simultaneously supporting economic growth and maintaining macroeconomic equilibrium.

Over the next three years, Uzbekistan is expected to experience steady positive growth in both the revenue and expenditure components of the state budget. This reflects the gradual expansion of fiscal policy measures and the strengthening of the state's fiscal capacity through the formation of a positive budget balance, which contributes to enhancing macroeconomic stability.

During the forecasted period, a stable increase in the gross domestic product of the Republic of Uzbekistan is anticipated, indicating positive trends in the country's economic development and laying the foundation for long-term sustainable growth. At the same time, obligations for servicing public debt will also increase. Despite the absolute growth in payment volumes, their relative level remains within acceptable limits and does not exceed established indicators of fiscal sustainability [2].



**Fig. 2. Forecasted GDP and public debt servicing volumes in the Republic of Uzbekistan for 2025–2027, trillion sum.**

Against the backdrop of a steady increase in real GDP—from 6.0% in 2025 to 6.3% in 2027—a simultaneous decline in the consumer price index from 7.1% to 5.0% is projected. This indicates a consistent implementation of inflation-containment policies while maintaining conditions conducive to further economic growth.

## Discussion

According to the International Monetary Fund (IMF), despite the reduction of the state budget deficit to 3.2% of GDP, public expenditure in Uzbekistan remains significant. This is largely driven by the active investment activities of state-owned enterprises and an increase in external

borrowing. The IMF forecasts the maintenance of stable economic growth rates at 5.8–5.9% over the coming years.

Based on the IMF mission report following the 2025 consultations, the Uzbek economy demonstrates sustainable development despite rising external risks and uncertainties. In 2024, real GDP growth reached 6.5%, supported by continued strong domestic demand.

The current account deficit declined by 2.6 percentage points, reaching 5% of GDP. This improvement was facilitated by increased remittance inflows, favorable commodity price conditions, growth in non-commodity exports, and a gradual reduction in imports.

In 2024, the consolidated budget deficit decreased by 1.7 percentage points to 3.2% of GDP. According to the IMF, this outcome was primarily the result of reduced energy subsidies and improved targeting of social transfers. At the same time, rising global gold prices offset a decline in value-added tax (VAT) revenues caused by higher VAT refunds.

Thus, even with the reduction of the budget deficit—a measure aimed at curbing domestic demand and alleviating inflationary pressures—overall government expenditures, including spending by state-owned enterprises, continued to increase.

Additionally, external borrowing rose as the government attracted additional funds from abroad, exceeding the established limit. This enabled state institutions to expand spending despite the formal reduction in the budget deficit.

Although the official budget deficit was reduced, the growth of debt obligations and increased expenditures by state-owned enterprises resulted in a high level of total government spending, weakening the intended cooling effect on economic activity.

Inflation, despite progress in its containment, remains elevated: in March 2025, the annual inflation rate reached 10.3%. The main drivers of price increases were the previous year's rise in tariffs for energy and regulated services.

According to the IMF's baseline forecast, Uzbekistan's economy is expected to grow by 5.9% in 2025 and by 5.8% in 2026, despite ongoing external uncertainty. The increase in global tariffs has heightened instability and tightened financial conditions in international markets, potentially affecting the country's economy through reduced external demand, fluctuations in commodity prices, and changes in capital flows.

The IMF assesses that the key drivers of economic growth will be the expansion of private consumption, increased investment activity, and the continued implementation of structural reforms.

## Conclusions

According to the International Monetary Fund (IMF), despite the reduction of the budget deficit to 3.2% of GDP, public expenditures in Uzbekistan remain substantial due to active investment activities by state-owned enterprises and an increase in external borrowing. The Fund forecasts that stable economic growth rates of 5.8–5.9% will be maintained in the coming years. The current account deficit declined by 2.6 percentage points, reaching 5% of GDP, driven by higher remittance inflows, elevated commodity prices, growth in non-commodity exports, and a gradual reduction in imports. At the same time, international reserves remain at a stable level.

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Based on these developments, the IMF suggested several measures for the Central Bank of the Republic of Uzbekistan, including improving taxation of enterprises and individuals, eliminating ineffective tax exemptions, and mitigating the impact of gold price fluctuations on budget expenditures. The Fund also recommended accelerating the privatization of state-owned banks and reassessing the strategy for maintaining systemically important banks, highlighting potential fiscal risks.

Among the proposals for the Central Bank is the gradual widening of the fluctuation range of the Uzbek sum, enabling the national currency to better reflect market conditions and serve as an effective buffer against external shocks.

According to the Fund, Uzbekistan has made significant progress in implementing market reforms; however, transitional reforms still need to be completed. The IMF urged the country to expedite the adoption of legislation on the declaration of public officials' income and to shift focus from direct government intervention toward the development of market institutions and effective economic regulation.

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