



**MONETARY POLICY TRANSMISSION AND ITS IMPACT ON
INVESTMENT ACTIVITY: EVIDENCE FROM EMERGING
ECONOMIES**

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ABSTRACT	KEYWORDS
<p>This article analyzes the impact of monetary policy transmission mechanisms on investment activity in developing economies. The study examines the effects of the central bank’s interest rate, money supply, inflation rate, and credit volume on investment activity. In addition, the processes through which monetary policy is transmitted to the economy via the interest rate channel, credit channel, and exchange rate channel are discussed from both theoretical and empirical perspectives.</p>	<p>Monetary policy, transmission mechanism, investment activity, interest rate, inflation, credit channel, developing economies</p>

Introduction

In the current global economic environment, monetary policy is considered one of the key tools for ensuring economic stability and stimulating investment activity. In particular, in developing economies, the impact of monetary policy measures implemented by central banks on the real sector and investment processes is of special importance. The effective functioning of monetary policy transmission mechanisms plays a crucial role in controlling inflation, supporting economic growth, and maintaining financial stability.

The impact of monetary policy on the economy is transmitted through various channels. Among them, the interest rate channel is considered one of the main and most widely used mechanisms. Changes in the policy interest rate by the central bank directly affect the cost of commercial bank loans, the volume of lending, and the investment decisions of business entities. As a result, changes occur in investment activity and the pace of economic growth.

In developing countries, the effectiveness of the monetary policy transmission mechanism appears to be more complex compared to developed economies. This may be due to factors such as underdeveloped financial markets, problems within the banking sector, high inflation rates, and exchange rate instability. Therefore, scientifically studying the extent to which monetary policy instruments affect investment activity in these countries remains one of the most relevant issues.

LITERATURE REVIEW

The issue of monetary policy and its impact on the economy has long been one of the major research areas in economics. There are various theoretical approaches explaining monetary policy transmission mechanisms, among which the Keynesian and monetarist schools occupy a special place.

According to Keynesian theory, the interest rate is one of the main factors directly affecting investment activity. This approach argues that a decrease in interest rates reduces the cost of credit resources, encouraging firms to implement investment projects more actively. Conversely, an increase in interest rates leads to a reduction in investment expenditures. John Maynard Keynes emphasized the important role of the cost of capital and interest rates in investment decisions.[1]

Monetarists, on the other hand, placed great emphasis on the role of money supply as the main factor in the economy. One of the leading representatives of this approach, Milton Friedman, demonstrated that monetary policy has a significant impact on economic activity and inflation processes. In monetarist theory, the regulation of money supply by the central bank is considered an important tool influencing economic growth and investment activity.[2]

In modern economic research, monetary policy transmission is explained through several channels. These include the interest rate channel, the credit channel, the exchange rate channel, and the asset price channel. Through the interest rate channel, the central bank's policy rate affects the lending rates of commercial banks, thereby causing changes in investment volumes. The credit channel reflects the impact of banks' lending capacity on the activities of the real sector.[3]

In addition, the credit channel theory proposed by Ben Bernanke provides a deeper explanation of the mechanism through which monetary policy affects the economy via the banking system. According to this approach, changes in the volume of bank lending significantly influence firms' investment decisions. This factor becomes even more important in developing economies where the banking sector serves as the primary source of financing.

RESEARCH METHODOLOGY

This study analyzes the impact of monetary policy transmission mechanisms on investment activity in developing economies using empirical and statistical methods. Alongside theoretical approaches, econometric analysis methods are also employed in the research process.

ANALYSIS AND RESULTS

Within the framework of the study, the impact of monetary policy transmission mechanisms on investment activity in the economies of Uzbekistan and Kazakhstan was comparatively analyzed. The analysis mainly focused on the effects of central banks' policy interest rates, inflation levels, and lending volumes on investment activity.

In recent years, Uzbekistan has pursued a tight monetary policy aimed at controlling inflation while simultaneously increasing investment activity. Changes in the central bank's policy interest rate directly affected the cost of commercial bank loans and investment processes.

According to statistical data, due to high inflationary pressure in 2022, the policy interest rate in the country was increased to 17 percent. Later, as inflationary processes became relatively more stable, the interest rate was gradually reduced and reached 13.5 percent in 2024, while from March 2025 it was set at 14 percent.

The dynamics of the policy interest rates led to the following economic processes:

- changes in the cost of credit resources;
- increases or decreases in the financing costs of investment projects;
- changes in private sector investment activity.

The relationship between the interest rate and investment volume can be expressed through the following model:

$$I = I_0 - br$$

According to this model, an increase in the interest rate leads to a decrease in the volume of investment. This is because, under conditions of high interest rates, credit funds become more expensive, reducing the profitability of investment projects for enterprises.[3]

The table below illustrates the dynamics of the policy interest rate and investment volume:

Figure 1. Policy interest rate in the Republic of Uzbekistan.[4]

Validity period	%
24.03.2025 — ...	14.0
26.07.2024 — 23.03.2025	13.5
17.03.2023 — 25.07.2024	14
22.07.2022 — 16.03.2023	15
10.06.2022 — 21.07.2022	16
18.03.2022 — 09.06.2022	17
11.09.2020 — 17.03.2022	14

Figure 2. Investments in Fixed Capital in the Republic of Uzbekistan (billion UZS). [5]

2020	2021	2022	2023	2024
210195,1	239552,6	266240	356071,4	507,490

In 2022, as a result of the tightening of monetary policy, the policy interest rate was maintained at a high level. In particular, the rate was kept at 17 percent during March–June, 16 percent during June–July, and 15 percent from July 2022 to March 2023. During this period, the growth of investments in fixed capital remained relatively slow, amounting to 11.1 percent. Compared to the investment activity observed in previous years, this indicator was considered low.

This situation can be explained through the monetary policy transmission mechanism. The increase in the policy rate raised the cost of commercial bank loans and increased the expenses associated with borrowing funds. As a result, the net present value (NPV) and internal rate of return (IRR) of investment projects declined, making many projects less attractive to investors. Consequently, enterprises postponed the implementation of new investment projects or temporarily abandoned them. In contrast, during 2023–2024, the gradual reduction of the policy rate stimulated investment processes. From March 17, 2023, the rate was reduced to 14 percent, and from July 26, 2024, it was lowered further to 13.5 percent. Under these conditions of accommodative monetary policy, investments in fixed capital increased significantly. In particular, in 2023 the volume of investments amounted to 356.1 trillion UZS, representing an increase of approximately 33.7 percent compared to the previous year. In 2024, this figure reached 507.5 trillion UZS, recording an additional growth of 42.5 percent.

Overall, the results of the analysis indicate the existence of an inverse relationship between the policy interest rate and investment activity. In other words, high interest rates constrained investment growth, while reductions in interest rates contributed to a significant recovery in investment activity.

Analysis of Monetary Policy Transmission and Investment Activity in the Case of Kazakhstan

Based on the given data, it can be observed that during 2020–2024, the volume of investments in fixed capital in Kazakhstan demonstrated an overall positive growth trend. In particular, the volume of investments increased from 12,670.1 billion tenge in 2020 to 19,461.3 billion tenge in 2024, growing by nearly 1.5 times. This process indicates the gradual recovery and expansion of investment activity within the country’s economy.

At the same time, the growth rates of investments were closely connected with monetary policy, particularly with changes in the policy interest rate.

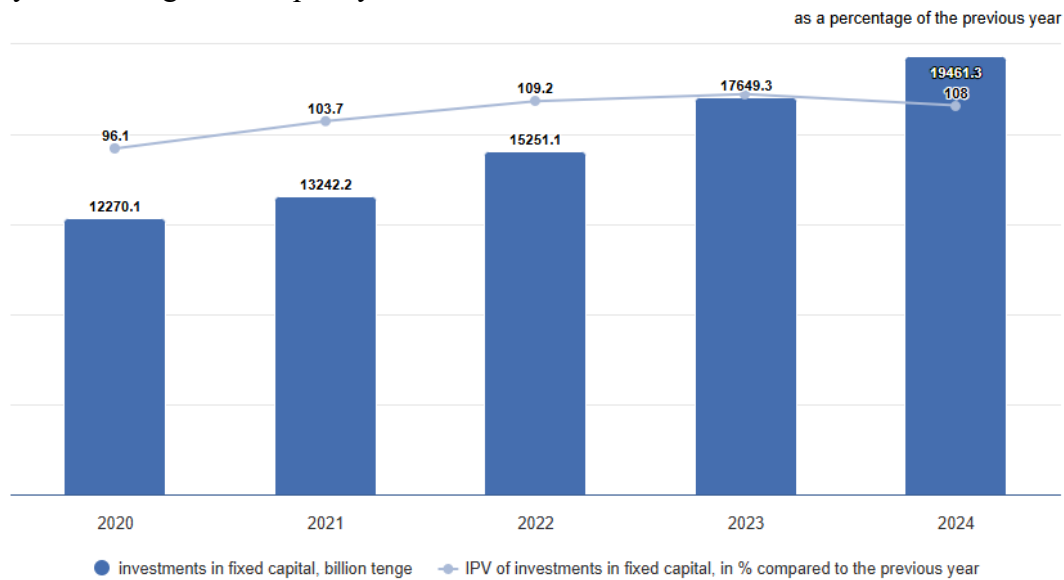


Figure 3. Investments in fixed capital in the Republic of Kazakhstan. [6]

Figure 4. Policy interest rate in the Republic of Kazakhstan. [7]

Validity period	%
13.10.2025-...	18
11.03.2025-13.10.2025	16.50
02.12.2024-11.03.2025	15.25
15.07.2024-02.12.2024	14.25
03.06.2024-15.07.2024	14.50
26.02.2024-03.06.2024	14.75
22.01.2024-26.02.2024	15.25
27.11.2023-22.01.2024	15.75
09.10.2023-27.11.2023	16.00
28.08.2023-09.10.2023	16.50
06.12.2022-28.08.2023	16.75
27.10.2022-06.12.2022	16.00
26.07.2022-27.10.2022	14.50
26.04.2022-26.07.2022	14.00
24.02.2022-26.04.2022	13.50
25.01.2022-24.02.2022	10.25
26.10.2021-25.01.2022	9.75
14.09.2021-26.10.2021	9.50

In 2020, due to the pandemic conditions and economic uncertainties, the volume of investments amounted to 96.1 percent compared to the previous year, indicating a decline. However, in 2021, the recovery of economic activity and the maintenance of the policy interest rate at a relatively low level (9–9.75%) contributed to the growth of investment volume. As a result, investments reached 13,242.2 billion tenge, while the growth rate amounted to 103.7 percent.

In 2022, a sharp tightening of monetary policy was observed. In particular, the policy rate, which stood at 10.25 percent at the beginning of the year, was gradually increased due to rising inflationary pressures, reaching 16 percent by the end of the year and 16.75 percent from December 2022. Despite this, the volume of investments reached 15,251.1 billion tenge in 2022, recording a growth rate of 109.2 percent.

This situation can be explained by several factors. First, high commodity prices and increased export revenues ensured an inflow of additional financial resources into the economy. Second, the continuation of state investment programs and infrastructure projects supported investment activity. At the same time, from the perspective of the monetary transmission mechanism, it should be noted that the sharp increase in the policy rate acted as a factor limiting the growth rate of investments. This is because rising interest rates increased the cost of credit resources and slowed down certain segments of private sector investment.

In 2023, although monetary policy remained relatively tight, the policy rate gradually began to decline during the year from 16.75 percent to the range of 15.75–16 percent. During this period, the volume of investments reached 17,649.3 billion tenge, while the growth rate amounted to 106.9 percent. This indicates that economic agents had adapted to high interest rates to a certain extent and that economic activity continued to recover.

In 2024, the easing of monetary policy became even more evident. Throughout the year, the policy rate was gradually reduced to the range of 14.25–15.25 percent. As a result, the volume of investments in fixed capital reached 19,461.3 billion tenge. This confirms that lower interest rates stimulate investment activity. The reduced cost of borrowed funds expanded enterprises' opportunities to finance investment projects and positively influenced the adoption of new investment decisions.

CONCLUSION

This study analyzed the impact of monetary policy transmission mechanisms on investment activity using the examples of developing economies. The research findings showed that the interest rate policy implemented by the central bank has a direct and significant impact on investment processes. In particular, changes in the policy rate influence the cost of credit resources, financing opportunities, and investors' economic expectations, thereby shaping the level of investment activity.

The analysis demonstrated that during periods of monetary tightening, increases in interest rates reduce the profitability of investment projects and lead to a slowdown in private sector investment. This situation became especially evident in 2022, when high policy rates contributed to lower growth rates of investment. Conversely, the easing of monetary policy and the reduction of the policy rate contributed to the relative cheapening of credit resources and supported the recovery of investment activity.

Furthermore, the experiences of Kazakhstan and Uzbekistan showed that the effectiveness of the monetary transmission mechanism in developing countries is closely related to the level of financial market development, the stability of the banking system, inflation expectations, and the state's

economic policy. In developing economies, the credit channel emerged as one of the main transmission mechanisms, with changes in interest rates having a rapid impact on investment decisions.

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