



Issues of Regulation of the Practice of Lending to Individuals by Commercial Banks of the Republic of Uzbekistan

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Abstract: *Direct or indirect regulation of lending practices in the banking and financial system serves to prevent and minimize negative situations that may occur. In particular, coordination of lending practices of commercial banks to individuals, regulation of borrowers and co-borrowers through debt burden is widely used in international practice. In this regard, regulation of lending practices of individuals in commercial banks by the Central Bank and its improvement is considered a key factor in sustainable development of the banking system. In this article, the theoretical aspects of lending to individuals are researched and relevant recommendations are developed.*

Keywords: *credit, debt burden, purchasing power of borrowers, inflation, consumer spending, population income, asset risk, mortgage loan, NPL, GDP, Central Bank.*

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Introduction

In the Republic of Uzbekistan, a number of reforms are being implemented to increase the welfare and income of the population and ensure their employment. Commercial banks offer loans to various segments of the population on commercial and preferential terms. As a result, as of January 1, 2023, the share of loans allocated by banks to the population in the total loan portfolio was 25.9%, which increased by 4.6 % compared to January 1, 2022 (21.3%).

Although the situations above are considered positive, they also come with problematic and negative aspects, which require regulation and coordination by the regulators. Aggressive policy of commercial banks in retail crediting operations and a sharp increase in the volume of lending to individuals will cause negative situations in the future. In particular, the following negative outcomes can be observed in the economy and banking system:

1. The transformation of needs of individuals into demand at the expense of bank loans causes a sharp increase in gross demand. Following the boost in aggregate demand, the price of goods and

services in the economy increases and causes demand inflation. In this case, auto loan and mortgage lending practices by commercial banks will increase and the price of cars and houses will increase in the primary and secondary market. For example, as a result of the increase in the volume of mortgage lending to individuals in the USA, housing prices rose to a high level and caused the world financial and economic crisis in 2007. One of the main reasons for the global financial crisis in 2007-2008 was the rapid increase in the debt burden of the population.

2. The spike in lending to individuals will increase the debt burden of borrowers, and in the future, loans will become non-performing loans (NPLs) due to non-payment on time. As a result, asset quality of banks will decrease, credit and liquidity risk will increase and will cause a chain crisis in the banking system.

3. The increase in the share of loans allocated to the population in the income of the population, the increase in the level of the debt burden of the population will cause depression in families and increase social problems in the society.

4. In the future, non-fulfillment of the obligations of individuals with respect to goods and other large objects received on account of term payment will have a negative impact on the activities of enterprises and dealers operating on the basis of term payment in the future.

Bank of International Settlements economists M. Lombardi, M. Mohanty and I. Shim conducted a study of 54 countries in 1990-2015. According to it, there will be a positive relationship between the loans allocated to the population and the GDP for a short period of one year. But in a period of more than a year, a 1% increase in loans can lead to a 0.1% reduction in GDP. It has been noted that the ratio of household debt to GDP exceeding 60 percent has a negative effect on economic growth, and such a negative effect is especially strong in cases where the ratio of debt to GDP is higher than 80 percent[1].

Based on the above, it should be noted macro-level regulation of lending to individuals is one of the urgent issues. The Central Bank, as a regulator, carries out macroprudential control over lending practices of individuals.

Literature review.

In international studies, it has been found that there is a positive correlation between loans allocated to the population and the value of GDP per capita. Analyses based on 2020 data have shown that the level of the ratio of loans to the private sector to GDP is also forming in accordance with the value of GDP per capita in developed countries[2].

In the last two decades, the debt burden of the population around the world has increased dramatically. As a result of the global financial crisis, the rapid decline in consumption among highly indebted households caused a reduction in aggregate demand in the economy. In addition, since the crisis, debt burden levels have continued to climb to new heights. This, of course, requires research on the relationship between debt and consumption of the population from a theoretical and empirical point of view.

In the economic literature, in the period before the world financial economic crisis, the positive effect of the total debt of the population on economic growth was noted and considered as a positive factor. For example, F. Mishkin[3], K. Mervin[4], G. Debelle[5] found that household debts play an important role in economic activity. They argue that individuals are more sensitive to changes in income and interest rates when they face a high debt burden.

M. Lombardi and others provide empirical evidence that although household debt strengthens the economy in the short term, it hinders economic growth in the long term [1].

The research by A. Mian and A. Sufi shows that in the period before the crisis, the demand of households for credit increased. Increasing credit of the population requires the population to spend less and save more. A decrease in consumer spending leads to a decrease in the aggregate demand for goods and services. As a result, production and service provision will decrease and the number of the unemployed will increase. To the question of how such a cycle ends, the authors answer: "With a direct attack on debt", that is, people with reduced income or unemployment turn to bank loans, further increasing the debt burden [6].

M. Drexmann, M. Juselius found in their research that debt service burdens have a negative impact on credit and spending growth and indicate the possibility of future recession and financial crisis[7] .

In J.J. Xiao and R. Yao's studies, the effect of household loans on families was evaluated. In it, multivariate logistic regression results of several socioeconomic variables show that married couples with children have more debt than other types of families. Families with two children are more likely than other families (married without children, single men, and single women) to be 60 or more days in arrears[8].

In a study by L.M. Berger, J.Collins, different types and levels of debt were studied with depressive symptoms in the US population. The results show that household debt is positively associated with more depressive symptoms. This association was particularly strong among adults aged 51-64, those with a high school education or less, and those who were not married during the follow-up period. Research shows that short-term debt can have a psychologically negative effect, especially for those with little education, near retirement age, or those who are single[9].

Some studies have examined the debt burdens of different households and their impact on consumption. Baker (2018) found that highly indebted households are more sensitive to income changes due to borrowing and liquidity constraints[10].

Agnes Kovacs, May Rostom, Philip Bunn use household-level data in the UK and estimate that young families have significantly reduced their consumption in the post-crisis period when they have a higher debt burden compared to the average household. Indebtedness generally varies according to the type of debt instruments held by households[11].

Nakajima estimated a significant relationship between income elasticity of consumption and debt burdens for Japanese households. Research shows that the consumption elasticity of household income is much higher for highly indebted households than for households with little or no debt. The difference in income elasticity of consumption between a population with high debt and a person with little or no debt is significant only for negative changes in income[12].

Analysis and results.

In the banking system of the Republic of Uzbekistan, lending operations of commercial banks are carried out independently and administrative regulation operations by the Central Bank have been abandoned. According to the Regulation No. 905 of the Central Bank of the Republic of Uzbekistan adopted in 2000, "Requirements for credit policy of commercial banks" (currently revoked), banks should develop credit policy and organize independent lending operations.

Therefore, what measures should be taken to eliminate and reduce negative situations related to lending practices of individuals and that may occur in the future?

The Central Bank of the Republic of Uzbekistan widely uses the following instruments to regulate commercial banks' lending practices to individuals:

1. Determination of the risk level of loans allocated to individuals in commercial banks;
 2. Determining the debt burden of individual borrowers on loans (microloans);
 3. Determining the amount of loans allocated to individuals in laws and regulations.
1. Determining the risk level of loans allocated to individuals in commercial banks.

The risk level of loans allocated to individuals is determined based on the regulation No. 2693 of the Central Bank of the Republic of Uzbekistan "On the requirements for the capital adequacy of commercial banks", registered by the Ministry of Justice of the Republic of Uzbekistan on July 6, 2015 with No. 2693.

Based on the level of interest rates of loans allocated to individuals by commercial banks, the risk level is set up to 200 percent. In order to prevent individuals from increasing their payments and debt burden, high interest rate loans are assigned a high risk level. Banks provide loans at a high interest rate, the total amount of assets on the bank's account increases and the bank's capital ratios decrease.

Table 1

Risk levels of loans to individuals*

No	Annual interest rate	Risk level	Risk level for pending and delinquent loans
1.	in the national currency, the main rate of the Central Bank + 9 percent for loans and below	100%	200%
2.	in national currency from the main rate of the Central Bank + 9 percent band to the main rate of the Central Bank + 13 percent band	150%	
3.	loans in national currency with the main rate of the Central Bank + 13 percent and above	200%	

* except for mortgage loans

Source: Regulation No. 2693 of the Central Bank of the Republic of Uzbekistan dated July 6, 2015 "On requirements for the capital adequacy of commercial banks".

In addition, the risk level is set at 200 percent for loans with debts of banks that are in court and (or) have not been collected within the specified period. This requires taking measures to reduce problematic and litigation loans in commercial banks.

Table 2

Risk levels of residential mortgage loans

Description	Loan amount to collateral amount ratio (KGN)				Risk level for pending and delinquent loans
	KGN <50%	50%≤ KGN <75%	75%≤ KGN <100%	100%≤ KGN	
Risk level	35%	50%	100%	150%	200%

Source: Regulation No. 2693 of the Central Bank of the Republic of Uzbekistan dated July 6, 2015 "On requirements for the capital adequacy of commercial banks".

Mortgage loans to the population are provided with real estate and the liquid nature of the collateral, the risk level for these loans is set from 35 percent to 150 percent. Up to 200 percent of delinquent and pending mortgage loans are classified as risky assets.

2. Regulation of lending practices of individuals who borrow through debt burden.

Loans to borrowers in accordance with Regulation No. 3205 "On the procedure for calculating the debt burden of borrowing individuals on loans (microloans), the permissible amount of debt burden, as well as limiting the growth of debt burden" registered by the Ministry of Justice of the Republic of Uzbekistan on December 19, 2019 or when disbursing microloans, the procedure for calculating the debt burden, the permissible amount of the debt burden, limiting the growth of the debt burden, including the highest daily interest rates, are regulated.

The debt burden indicator is determined by the ratio of the monthly average payment of the allocated loan and the average monthly payments of the borrower and co-borrower on all available loans (microloans) to the amount of the approved average monthly income of the borrower and co-borrower.

According to the regulation, the debt burden indicator is calculated when the sum of the sum of the loan (microloan) and the principal balance of the borrower under the current loan (microloan) contracts exceeds 50 times the amount of the basic calculation.

Also, in order to limit the debt burden, the Central Bank has established that the debt burden indicator of an individual should not exceed 50 percent when disbursing loans (microloans) from the lender. The maximum daily interest rate for all credit (microloan) contracts allocated by the lender to individuals should not exceed 0.3 percent, but the amount of interest, brokerage fees, fines and other liability measures should not exceed half of the annual loan amount.

When determining the amount of credit allocated to individuals, the debt burden indicator is used, and the debt burden indicator should not be higher than the specified 50 percent. When the borrower's debt burden exceeds the specified limit, the bank employee must offer the client an alternative amount.

In the process of granting credit, the responsible employee of commercial banks should explain in detail to the borrower that failure to fulfill the obligations to repay the loan on time will lead to the calculation of penalties and fines on the loan, the debt burden will increase, delayed payments will have a negative impact on their credit history, and the possibilities of obtaining a loan may be limited in the future.

There are mainly 3 methodological approaches in international practice when assessing the credit burden of individuals from a macroeconomic point of view

- 1) Payment-to-income ratio indicator,
- 2) Debt-Service-Ratio
- 3) Debt-to-GDP indicator is used.

At the macro level, it is possible to evaluate the general situation from the analysis of data such as aggregated statistical data for the country, including the total credit debt of the population (credit balance allocated to individuals by commercial banks), the total income of the population, and the size of the gross domestic product.

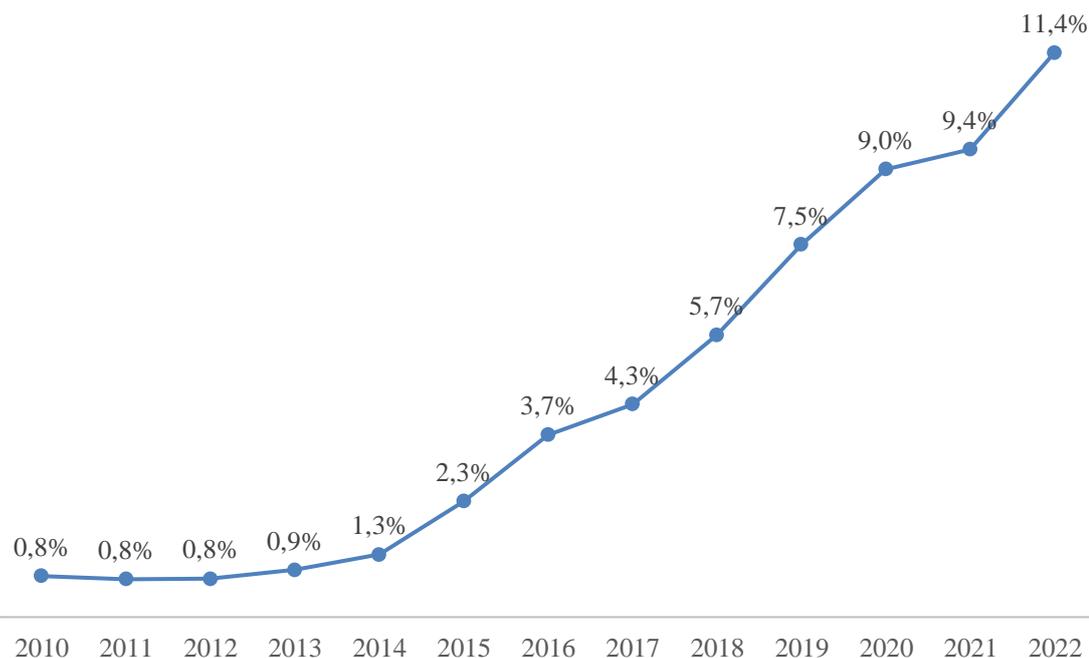


Diagram 1. Changes in the share of the balance of loans allocated to the population of commercial banks of the Republic of Uzbekistan in GDP, (%).

Source: compiled by the author based on the information of the Central Bank of the Republic of Uzbekistan.

The share of the balance of loans allocated by commercial banks to individuals in GDP has steadily increased in 2010-2022. The reason for the relatively high change in 2017-2022 during the analysis period is explained by the fact that in the Republic of Uzbekistan in recent years, within the framework of state programs, the volume of mortgage loans has been significantly increased in order to improve the housing conditions of the population, and the volume of credit funds directed to financial support of their entrepreneurial activities has increased.

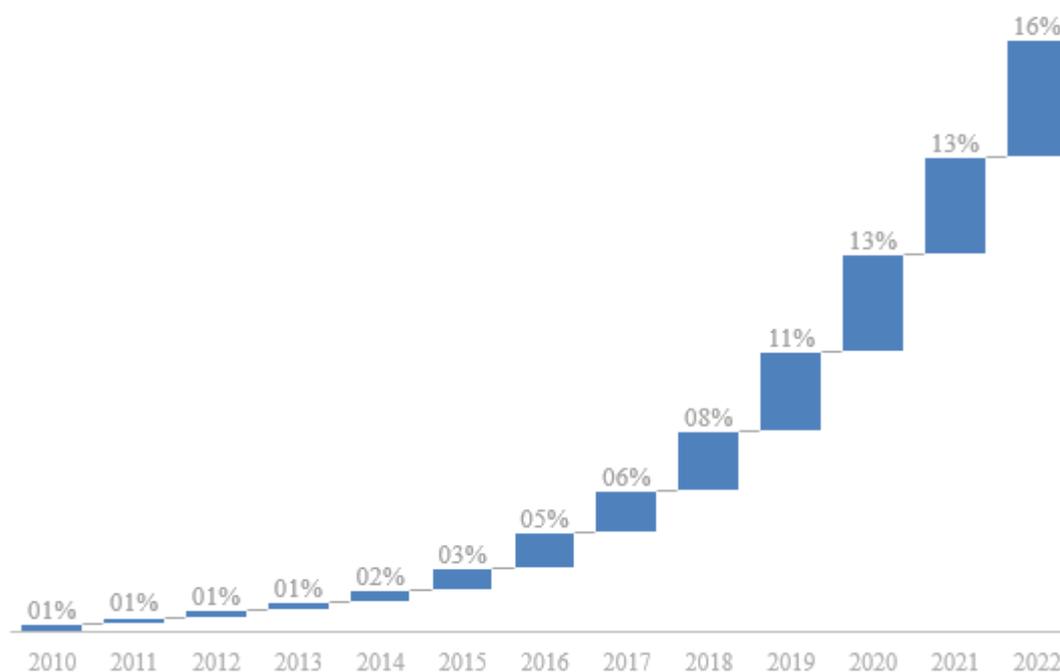


Diagram 2. Changes in the share of the balance of loans allocated to the population by the commercial banks in the Republic of Uzbekistan, in the income of the population, (%).

Source: compiled by the author based on the information of the Central Bank of the Republic of Uzbekistan.

In the Republic of Uzbekistan, the share of the balance of loans allocated to the population by commercial banks in the income of the population has increased to about 16% during the analysis period. During the period of analysis, the balance of loans allocated to individuals in the banking system as a share of the total population income has grown at a high rate in 2018-2019 and 2021-2022.

In addition, the above analysis does not include information on sales of auto loans in the primary and secondary markets, and other household goods on the basis of installment payments. If the information about transactions made on the basis of term payment outside the banking system is taken into account, the debt burden of the population may be much higher than the level determined in the analysis process.

According to the analytical data of the Central Bank of the Republic of Uzbekistan, 60-70 percent of the total mortgage loans in 2018-2021 were mortgage loans with a ratio of loan payment to income (PTI) higher than 51 percent[13].

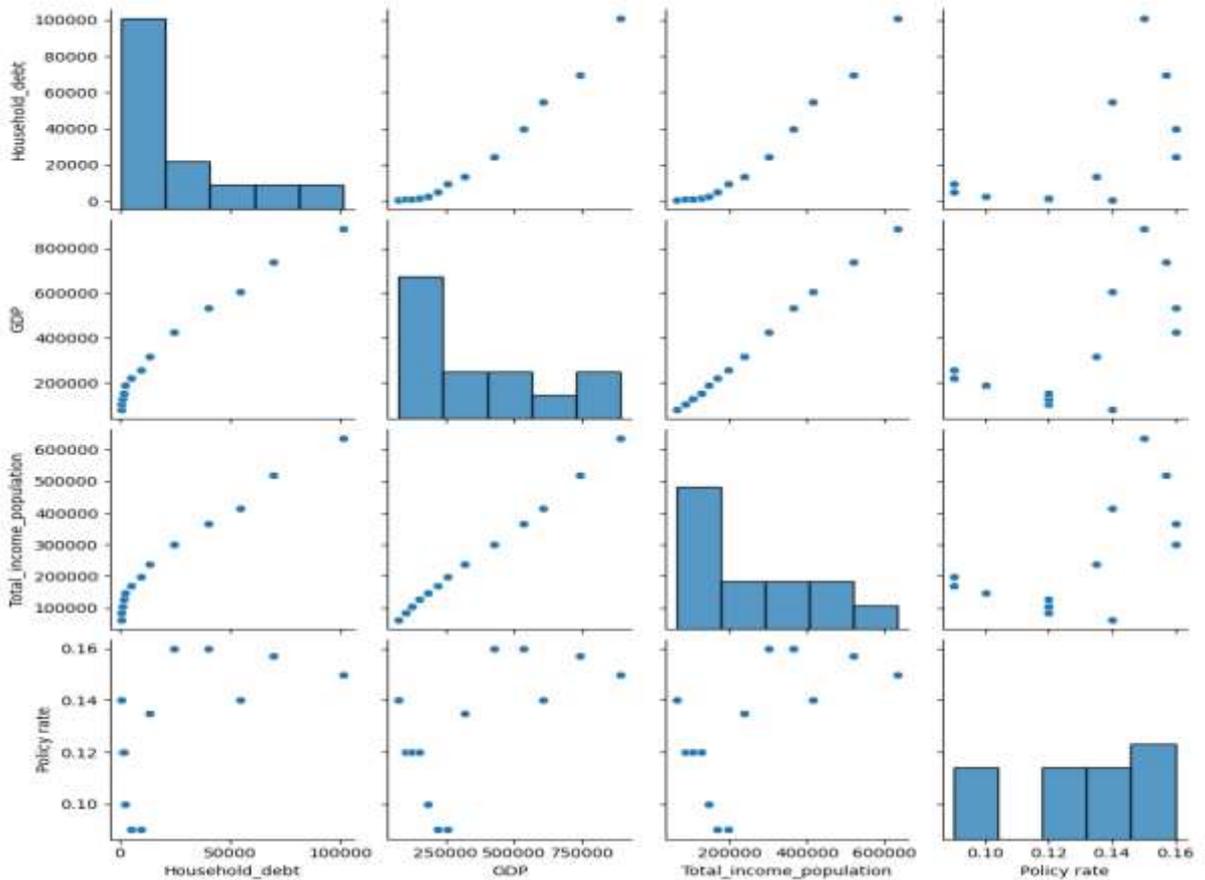


Diagram 3. Correlation of loans allocated to households of the Republic of Uzbekistan with macro indicators

Source: Compiled by the author in Python programming language.

During the period of analysis (2013-2022), the correlation with changes in the balance of loans allocated to households, GDP, population income and the Central Bank refinancing rate was observed. The correlation was especially high in changes in GDP and total income of the population.

It is possible to assess the degree of correlation between the above analytical data by correlational analysis. The results of correlation (method='pearson') analysis of factors influencing the balance of loans allocated to individuals by commercial banks of the Republic of Uzbekistan are presented in the following figure.

Population income (0.98) and GDP (0.98), population growth (0.9) are highly related to the factors affecting the change of the balance of loans allocated to individuals in 2010-2022. In addition, the Central Bank's refinancing rate (0.61) had a weak correlation. It can be seen that there is an inverse relationship with the country's inflation rate (-0.14).

3. Determining the amount of loans allocated to individuals in laws and regulations.

The amount of loans allocated to the population by commercial banks in the Republic of Uzbekistan is regulated by law and bylaws. According to Article 5 of the Law No. 765 dated April 20, 2022 of the Republic of Uzbekistan "On Non-Bank Credit Organizations and Microfinancing Activities", it is noted that "a borrower who is a natural person can be given a microloan in the amount not exceeding fifty million soums on the basis of solvency, term and repayment conditions" done[14].

The maximum limits for lending to individuals on a preferential basis and to certain categories of the population are determined by legal documents. Also, the amount of loans allocated for business activities of the population is limited. In particular, according to the decision of the President of the Republic of Uzbekistan No. 4701 "On additional measures to improve the housing conditions of the population and further expand the mortgage credit market", the maximum amount of mortgage loans allocated to the population is determined in the region[15].

According to the Decision of the President of the Republic of Uzbekistan dated June 7, 2018 No. 3777 "On the implementation of the "Every family-entrepreneur" program, up to 33 million soums will be allocated to individuals with entrepreneurial initiatives based on the recommendations of the assistant governor attached to each neighborhood [16].

The maximum amount of loans allocated in accordance with the above legal documents is set for regulation in order to ensure the correct distribution of the population and the areas where they live.

Conclusions and suggestions.

Based on the results of the research and analysis, the following scientific recommendations were developed:

1. In order to regulate the debt burden of the Central Bank in the Republic of Uzbekistan, the formation of a database on the indebtedness of individuals in commercial banks and non-bank credit organizations would be a reasonable solution. Transactions concluded on the basis of term payment from enterprises and dealers working on the basis of term payment to individuals should be included in this database.

2. It is appropriate to determine the debt burden of individuals based on the balance of debts on loans and term payments. At the macro level, the debt burden of the population is assessed and a clear conclusion can be drawn. Also, an accurate assessment of the level of debt burden in commercial banks serves to minimize credit risk when lending to individuals because nowadays, commercial banks determine the debt load based on the existing loan debts in other banks.

3. In order to prevent the negative impact of the debt burden of individuals on economic growth at the macro level, it is recommended that the Central Bank ensure the limit of the ratio of the debt burden of the population to GDP at the level of 50 percent.

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