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Priority Areas of Sustainable Development, Innovative Economy, and Regional Development

Causes of Inflation, Consequences and its Impact on the Modern Economy

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Abstract. *This article provides a detailed analysis of modern theoretical interpretations of inflation, its macroeconomic consequences, and management mechanisms. Monetarist, Keynesian, and new classical approaches are comparatively examined, and the impact of inflation on economic growth, income distribution, investment activity, and financial stability is assessed based on empirical evidence. Special attention is given to Uzbekistan's experience with inflation targeting for 2017–2025, discussing the effectiveness of policies and potential risks in a scientific context.*

Keywords: *inflation, inflation targeting, monetary policy, economic growth, distributive effect, macroeconomic stability, Uzbekistan*

Причины и последствия инфляции и её влияние на современную экономику

Аннотация. *В статье проводится подробный анализ современных теоретических подходов к трактовке инфляции, её макроэкономических последствий и механизмов регулирования. На основе сравнительного анализа монетаристского, кейнсианского и нового классического подходов рассматривается влияние инфляции на экономический рост, распределение доходов, инвестиционную активность и финансовую стабильность с учётом эмпирических данных. Особое внимание уделяется опыту Узбекистана в области инфляционного таргетирования в 2017–2025 годах. С научных позиций оценивается эффективность проводимой политики и анализируются связанные с ней потенциальные риски.*

Ключевые слова: *инфляция, инфляционное таргетирование, денежно-кредитная политика, экономический рост, распределительные эффекты, макроэкономическая стабильность, Узбекистан.*

Introduction. Inflation is one of the primary challenges of the modern economy, directly affecting the macroeconomic stability of every nation. As an economy develops, money circulation, the price system, and the balance between demand and supply constantly evolve. Among these processes, inflation is one of the most prominent factors, characterized by a continuous rise in the general price level, currency depreciation, and a decline in real household incomes. The nature of inflation is such that although it may stimulate economic growth in the short term, in the long term it disrupts economic equilibrium, widens inequality between social strata, and fuels social discontent. [8]

The causes of inflation are multifaceted, with key factors including:

- An increase in the money supply
- Large state budget deficits
- Slowdowns in production
- Rising prices for energy resources and raw materials
- High costs of imported goods

Furthermore, price fluctuations in global markets, geopolitical crises, and sharp shifts in consumer demand also exacerbate inflation. For instance, higher energy resource costs lead to increased production costs, triggering a chain reaction of price hikes across all sectors.[5]

Types and Degrees of Inflation

Macroeconomic theory identifies several types of inflation that help determine how economic processes shift:

- **Demand-pull inflation** occurs as a result of surging consumer demand. If production enterprises cannot meet this demand with their existing capacity, prices begin to rise.
- **Cost-push (supply-side) inflation** is associated with rising production costs, forcing businesses to adjust product prices to avoid losses.
- **Mixed inflation** is the most common form, in which both demand and supply factors act simultaneously.[8]

The degree of inflation also varies:

- **Moderate (creeping) inflation** is considered an integral part of economic growth. According to

data from the World Bank and the International Monetary Fund, an inflation rate of 2–5% is not harmful to the economy; on the contrary, it can stimulate economic activity.

• **High inflation:** If the rate exceeds 10%, sharp changes occur—bank interest rates rise, loans become expensive, and investments decline.

• **Accelerating (galloping) inflation:** Rates above 20% severely destabilize the economy.

• **Hyperinflation:** The most dangerous form, where prices change not by the day, but by the hour.[2]

Historical Context and Economic Impact

Hyperinflation has occurred several times throughout history. In 1923 Germany, the price of a single loaf of bread rose to several million marks. In 2008 Zimbabwe, inflation reached 231 million percent, forcing people to carry carloads of cash just to buy food. Such extreme situations lead to the complete collapse of the monetary system, the loss of public savings, and severe economic crises.The impact of inflation on the economy is complex and depends on numerous macro and microeconomic factors. First and foremost, inflation leads to currency depreciation. Real incomes drop, and the incentive to save diminishes, which negatively impacts the development of the banking system. For businesses, production costs increase, leading either to lower product quality or reduced output volumes. Some enterprises attempt to resolve the issue by raising prices, but this ultimately destabilizes the price market. Inflation also harms the investment climate; foreign investors exercise caution before committing capital to a high-inflation country, as it increases currency risks. Budgetary Impacts and the Uzbek Context Local businesses also refrain from investing in long-term projects due to uncertainty surrounding future price levels. Consequently, the economy's innovative development slows down. Inflation equally impacts the state budget:

• **Tax Revenues:** On one hand, rising prices can temporarily boost tax revenues as the tax base expands.

• **Fiscal Burden:** On the other hand, increased spending on social payments, subsidies, pensions, and public wages creates a heavy financial burden for the government.

If the state resorts to new currency issuance or increases domestic debt to cover these expenditures, it further fuels inflation. Therefore, maintaining a strict monetary policy is critical in combating inflation. Looking at inflation through the experience of Uzbekistan:

• **Post-Independence Era:** During the early years of independence, the economy endured a severe crisis. In 1993–1994, the inflation rate surged past 800%, driven by a sharp drop in production, the collapse of the Soviet economic framework, and an unformed national currency system.

• **Stabilization:** From the mid-2000s onward, inflation dropped significantly and the economy stabilized.

• **Post-2017 Reforms:** Major economic reforms—including currency market liberalization, customs reform, and price deregulation—exerted short-term inflationary pressure but created a solid foundation for long-term economic growth.[4]

Policy Tools and Psychological Factors

The inflation rate in Uzbekistan hovers around 9–10%, with bringing it down to 5% serving as one of the government's key priority targets.

Essential tools for curbing inflation include:

• Central Bank key rate adjustments

• Money supply management and credit regulation

• Optimization of public expenditure

• Strengthening market competition and expanding production capacity

• Strategic initiatives such as import substitution, energy efficiency improvements, and logistics upgrades

At the same time, inflation is driven not only by macroeconomic policy but also by **psychological factors**. Public expectations regarding price increases can become self-fulfilling: if consumers anticipate further price hikes, they accelerate their spending, causing a surge in demand that pushes prices higher still. This phenomenon is known as an "inflationary spiral."

Conclusion: Although inflation is an inherent feature of market economies, elevated inflation severely impedes economic development. Effectively managing inflation requires a synchronized approach involving state fiscal policy, Central Bank monetary measures, vibrant market competition, industrial diversification, and enhanced energy efficiency.[3] Uzbekistan’s reforms in recent years have been directed toward this goal, and maintaining the inflation rate around 5 percent remains a key factor in ensuring economic stability. The transition process to inflation targeting in Uzbekistan covering 2017–2025 represents one of the most critical stages of the country’s economic reforms. During this period, modernizing monetary policy, ensuring price stability, and creating a predictable macroeconomic environment for economic growth became top state policy priorities. In particular, the gradual implementation of the inflation targeting framework by the Central Bank, the deep integration of market mechanisms, and the increased openness of the economy allow for a scientifically grounded analysis of this strategy's effectiveness. Although the large-scale economic liberalization processes initiated in 2017—such as the liberalization of the foreign

exchange market, market-driven price formation, and gradual increases in energy and utility tariffs —exerted strong inflationary pressure, these reforms created the necessary conditions for establishing the inflation targeting framework. Throughout 2017–2020, inflation remained elevated (11–16%), yet this period provided invaluable experience for identifying the core drivers of inflation and refining control mechanisms. Beginning in 2020, the Central Bank formalized the inflation targeting framework, setting a medium-term target to lower inflation to 5%. To achieve this, the policy rate became the central instrument of monetary policy. Measures were intensified to heal the credit market, curb excessive growth in money supply, regulate banking system liquidity, and anchor public inflation expectations. Frequent policy rate increases during this phase, liquidity sterilization operations, and efforts to strengthen banking sector capitalization served as the core pillars of policy execution. Between 2021 and 2023, pandemic repercussions, global supply chain disruptions, rising transport and logistics costs, and energy market volatility complicated disinflation efforts. Consequently, inflation surpassed 12% again in 2022. Nevertheless, this period served as a litmus test for the resilience of the inflation targeting system, where the Central Bank's decisive stance played a pivotal role in averting broader economic instability. By 2024–2025, inflation in Uzbekistan began to gradually stabilize, reflecting the growing prominence of predictable and consistent monetary mechanisms within economic policy. Strengthening market competition, curbing monopolies, liberalizing the energy sector, optimizing public spending, and reinforcing fiscal discipline yielded positive outcomes in driving down inflation. Most importantly, public inflation expectations gradually eased, thereby enhancing the credibility of monetary policy.[6]

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