

INTEREST RATE POLICY OF COMMERCIAL BANKS: ITS NECESSITY AND
IMPORTANCE

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Abstract: This article explores the fundamental role of interest rate policy as a strategic framework for commercial banks in the modern financial landscape. It analyzes the necessity of such policies through the lens of financial intermediation, risk mitigation—specifically interest rate risk—and liquidity management. Furthermore, the paper discusses the importance of interest rate policy in driving profitability, fostering innovation in competitive markets, and serving as a critical link in the transmission of national monetary policy. The findings suggest that in an era of digital finance and global volatility, sophisticated, data-driven interest rate strategies are indispensable for both a bank's internal solvency and broader macroeconomic stability.

Keywords: Commercial Banks, Interest Rate Policy, Financial Intermediation, Net Interest Margin, Interest Rate Risk, Liquidity Management, Monetary Policy Transmission, Asset-Liability Management.

In the intricate machinery of modern financial systems, interest rate policy stands as a cornerstone for commercial banks, representing the strategic management of the "price of money"—the rates at which banks remunerate savers for deposits and charge borrowers for loans. As defined by foundational financial resources, this policy is not merely an operational tool but a deliberate framework that shapes the bank's profitability, risk profile, and role in the broader economy. Far beyond routine pricing decisions, interest rate policy embodies a bank's proactive response to market dynamics, regulatory pressures, and macroeconomic signals. In an era of volatile global interest environments—exemplified by the post-2008 low-rate regimes in advanced economies and subsequent inflationary spikes—this policy has evolved into a critical instrument for resilience. This evolution necessitates a sophisticated approach to Asset-Liability Management (ALM), where banks must meticulously balance the maturity profiles of their assets and liabilities to mitigate interest rate risk and ensure stable net interest margins. The calibration of these rates serves as a primary lever for liquidity management, dictating the flow of capital into various sectors and influencing the overall velocity of money within the financial ecosystem. Furthermore, as central banks adjust their benchmark rates to combat inflation or stimulate growth, commercial institutions must navigate the "pass-through" effect, determining how much of these changes to absorb and how much to transmit to their clientele. This decision-making process is further complicated by the rise of digital finance and increased competition, forcing banks to integrate real-time data analytics and predictive modeling into their policy formulations. Ultimately, a robust interest rate policy does not only safeguard a bank's solvency during periods

of fiscal tightening but also acts as a strategic driver for sustainable credit expansion, ensuring that the institution remains a stable pillar of the national economy even amidst the shifting tides of international financial markets.

The necessity of a robust interest rate policy arises first and foremost from the essence of banking: financial intermediation. Commercial banks serve as vital conduits, channeling funds from surplus economic units—such as households and corporations with excess savings—to deficit units hungry for investment capital, including entrepreneurs, infrastructure projects, and expanding businesses. Without a formalized policy, this intermediation process risks extreme inefficiency, as ad-hoc rate setting could lead to mismatched funding costs and lending yields that jeopardize the institution's long-term viability. Central to this structural equilibrium is the "interest rate spread," the critical differential between deposit rates (what banks pay savers) and loan rates (what they charge borrowers), which generates the Net Interest Margin (NIM)—a primary revenue stream essential for covering operational expenses, building capital reserves, and absorbing risk premiums.

Empirical studies underscore that banks with disciplined spread management achieve NIMs sufficient to weather severe economic downturns; for instance, during the European sovereign debt crisis (2010–2012), banks with adaptive policies maintained spreads above 2.5%, effectively buffering against deposit outflows and credit contraction. Furthermore, the strategic calibration of these rates acts as a signal to the market, influencing consumer behavior and the allocation of capital across diverse economic sectors. In emerging markets, such as those in Central Asia, where deposit bases are often volatile due to the prevalence of informal savings alternatives and shifting public trust, a clear and transparent policy ensures steady capital inflows, preventing liquidity crunches that could otherwise cascade into systemic instability. By integrating advanced risk-assessment models and macroeconomic forecasting, a robust policy also allows banks to manage "basis risk" and "re-pricing risk," ensuring that fluctuations in market benchmarks do not erode the bank's equity. Ultimately, this framework does more than just secure profitability; it reinforces the bank's role as a stabilizer in the financial ecosystem, facilitating sustainable credit growth and fostering an environment where both savers and investors can operate with a high degree of predictability and confidence.

Risk mitigation further amplifies the imperative for interest rate policy, particularly in combating "interest rate risk"—the vulnerability to profit erosion from adverse market rate fluctuations that can destabilize even the most established financial institutions. When central banks hike policy rates unexpectedly, as the U.S. Federal Reserve did in 2022–2023 to combat persistent inflation, banks face immediate and severe asset-liability mismatches: long-term fixed-rate loans become significantly less profitable relative to the rapidly rising costs of short-term deposits, which inevitably squeezes net interest margins. A formal policy, incorporating sophisticated duration matching, granular scenario analysis, and strategic hedging via interest rate swaps or other derivatives, equips banks to navigate such turbulence with precision. Observations from global banking crises reveal that institutions lacking such rigorous frameworks suffer outsized losses; the 1994 U.S. thrift crisis, triggered by sudden rate hikes, serves as a stark historical warning, as it wiped out billions in capital due to unhedged mortgage portfolios that could not be repriced. In contemporary contexts, with climate-related disruptions, digital bank runs, and geopolitical tensions increasingly influencing global rate volatility, policies integrating comprehensive stress testing—strictly aligned with Basel III accords—have become indispensable. These frameworks ensure that capital adequacy ratios remain robust and above regulatory thresholds even under extreme 200-basis-point shocks, protecting the bank's solvency. By proactively managing the "re-pricing gap" and implementing dynamic pricing

models, banks can transform interest rate policy from a defensive shield into a competitive advantage, allowing them to remain resilient in a high-inflation environment while continuing to provide the liquidity necessary for broader economic stability. This strategic foresight not only secures the internal balance sheet but also builds external market confidence, ensuring that the bank can fulfill its role as a stable lender regardless of the volatility in the underlying macroeconomic landscape.

Liquidity management constitutes another pillar of necessity, as interest rate policy dynamically balances deposit attraction and loan deployment. During liquidity shortages, competitive deposit rates draw in funds, stabilizing the balance sheet; conversely, in high-liquidity phases—such as post-pandemic quantitative easing floods—banks adjust lending rates downward to spur uptake, averting idle excess reserves. This dual function is especially vital in oligopolistic markets, like Uzbekistan's banking sector, where a handful of state-linked institutions dominate, and policy agility prevents customer flight to fintech alternatives offering superior yields. Research highlights that proactive liquidity-tuned policies correlate with lower funding costs; a study of Asian banks post-Asian Financial Crisis (1997–1998) showed those with flexible rate frameworks reduced liquidity coverage ratios by 15% through efficient deposit mobilization (ResearchGate). Thus, interest rate policy is not optional but foundational, embedding prudence into daily operations.

Turning to its importance, interest rate policy emerges as a performance driver for banks, profoundly influencing profitability amid rate-sensitive revenues. High real interest rates—adjusted for inflation—typically widen margins, as evidenced by correlations in panel data from over 1,000 global banks, where a 1% real rate increase boosts NIM by 0.3–0.5% (ScienceDirect). This sensitivity underscores policy's role in shareholder value creation, particularly in low-growth environments where fee income from non-interest activities lags. Competition intensifies this importance; in concentrated markets, rigid policies cede ground to rivals offering better rates, eroding market share. Flexible frameworks enable banks to counter this, fostering innovation such as high-yield digital savings accounts or variable-rate loans linked to benchmarks like SOFR or Euribor. Liberalized regimes, as seen in India's post-2010 deregulation, spurred product diversification—green bonds yielding 7–8% and AI-driven robo-advisory—offsetting margin compression from digital entrants.

For customers and the wider economy, interest rate policy acts as an economic throttle, modulating growth and stability. Lower rates democratize credit, fueling business investments, housing booms, and consumer durables; the U.S. housing surge pre-2008, driven by subprime rates below 6%, illustrates this stimulative power, though it warns of excesses. Conversely, rate hikes temper inflation by curbing spending—the European Central Bank's 2022 tightening cycle dropped Eurozone inflation from 10.6% to 2.5% within 18 months. Savings mobilization gains traction through attractive deposit rates, channeling household capital into productive avenues; in developing economies, policies yielding 4–6% real returns have boosted national savings rates by 5–10%, underpinning infrastructure like Uzbekistan's recent metro expansions. Critically, commercial bank rates serve as the "key link" in monetary policy transmission, amplifying central bank actions: a 25-basis-point repo rate cut ripples through lending rates, influencing GDP growth, employment, and exchange rates. Disruptions here, as in Japan's "lost decade" of zero rates failing to spur lending, highlight policy's macroeconomic leverage.

Broader observations reveal interest rate policy's evolving contours amid technological and regulatory shifts. Fintech disruptions demand dynamic pricing algorithms, while ESG mandates push "green premiums" on sustainable loans. In Uzbekistan, amid post-2020 reforms liberalizing

rates, banks like Ipak Yuli have widened spreads via digital platforms, enhancing transmission from the Central Bank's 14% policy rate. Yet challenges persist: negative real rates erode savers' incentives, while shadow banking siphons deposits. Policymakers must thus prioritize policies blending competition with safeguards, ensuring banks remain engines of inclusive growth.

In synthesis, the interest rate policy of commercial banks is indispensable for operational viability and pivotal for economic vitality. Its necessity in intermediation, risk control, and liquidity, coupled with importance in profitability, innovation, and policy conduction, positions it as a linchpin of financial architecture. As global uncertainties mount—from AI-driven disruptions to climate risks—banks adopting sophisticated, data-informed policies will not only thrive but fortify resilient economies.

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