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CONTENTS

MECHANISMS FOR FORMING AND IMPLEMENTING INVESTMENT POLICY OF COMMERCIAL BANKS... 8	Abduvaliyev Sanjar Abdurahmanovich
EVALUATION OF MANAGEMENT EFFICIENCY BASED ON BUDGETING IN ENERGY ENTERPRISES (A FACTOR ANALYSIS CASE OF "HUDUDGAZTA'MINOT" JSC)..... 17	Sobirov Shoyadbek Kurbonaliyevich
PORTFOLIO OF POSTAL SERVICES AND THE ECONOMIC EFFICIENCY OF ITS DIGITALIZATION23	Mamatkulov Gulom Rustamovich
OPTIMIZING THE BALANCE BETWEEN LIQUIDITY AND CREDIT RISKS IN ENSURING BANKING STABILITY30	Anvarov Asliddin Nabijon ugli
ECONOMIC EFFICIENCY OF RENEWABLE ENERGY DEPLOYMENT IN UZBEKISTAN.....34	Hamroyeva Sabina Ismoil qizi, Dilshod Anvarjonovich Ismailov
MODERN TRENDS AND EFFICIENCY OF LENDING TO AGRICULTURAL PRODUCERS IN UZBEKISTAN..39	Shamshetova Gulraushan Sarsenovna
ANALYSIS OF THE RELATIONSHIP BETWEEN YOUTH EMPLOYMENT AND CRIME (CASE OF UZBEKISTAN)42	Khusniddinova Gulnoza
PRIORITY DIRECTIONS FOR IMPROVING THE INFRASTRUCTURE OF UZBEKISTAN'S FINANCIAL SYSTEM47	Qobilova Nodira Qayumjon qizi, Normurodov Kh.E.
FOREIGN EXPERIENCE OF INCREASING THE EXPORT CAPACITY OF THE REGION AND SPECIFIC FEATURES OF ITS APPLICATION IN UZBEKISTAN52	Mamadzhanova Tuygunoy Akhmadzhanovna
INSTITUTIONAL APPROACH TO WASTE MANAGEMENT AND ITS ECONOMIC EFFICIENCY56	Otbosarov Abrorbek Adhamjon o'g'li
LOSS MANAGEMENT MATRIX (LOSS MANAGEMENT MATRIX) MODEL IN POWER GRID ENTERPRISES..61	Khojimurodov Zukhriddin Shukurullo oglu
MICROPROJECTS AS A MEANS OF INCREASING THE FINANCIAL ACTIVITY AND LITERACY OF THE POPULATION67	Irgashev Anvar Farxodovich
INSTITUTIONAL VA TEXNOLOGIK O'ZGARISHLAR SHAROITIDA INNOVATION BANK XIZMATLARINI JORIY ETISH METODOLOGIYASINI TAKOMILLASHTIRISH.....74	Azlarova Aziza Axrorovna
PROBLEMS OF FORMATION AND DEVELOPMENT OF REGIONAL CLUSTERS IN THE LIGHT INDUSTRY OF UZBEKISTAN80	Umarkulov Kodirjon Maxamadaminovich
DIGITAL FINANCIAL INCLUSION AS A DRIVER OF SUSTAINABLE DEVELOPMENT: EVIDENCE FROM GLOBAL TRENDS AND IMPLICATIONS FOR EMERGING ECONOMIES.....84	Sabitov Oybek Abduganievich, Sattoriy Fayzullokh Abdijabbor ugli
PROPERTIES OF HEAVY CONCRETE DISPERSEDLY REINFORCED WITH NON-METALLIC FIBERS AND SPECIFIC FEATURES OF CALCULATING CONCRETE STRUCTURES BASED ON THEM90	Usmonova Durdona, Gulomova Dilnura
THE EFFECT OF STABLE AND DYNAMIC PRICING ON CONSUMER BEHAVIOR98	Anvar DEBERDIYEV
ECONOMIC MECHANISMS FOR IMPROVING PRODUCTION EFFICIENCY IN INDUSTRIAL ENTERPRISES.. 102	M.O. Yo'ldoshova

PEDAGOGICAL EFFECTIVENESS OF ARTIFICIAL INTELLIGENCE TECHNOLOGIES IN TEACHING POLITICAL SCIENCE AT HIGHER EDUCATION INSTITUTIONS	106
Rasulev Bobirjon Atkhamovich	
IMPROVING THE ORGANIZATIONAL AND ECONOMIC MECHANISM FOR REGULATING NON-STANDARD EMPLOYMENT IN THE DEVELOPMENT OF SMALL BUSINESSES	110
Fayzullayev Nurulla Bakhromovich	
PRIORITIES FOR IMPROVING THE HEALTHCARE FINANCING SYSTEM IN UZBEKISTAN	117
Gulira'no Atabekovna Ruzmetova	
FACTORS AFFECTING TAX PAYMENT SYSTEMS, EXISTING PROBLEMS, AND THEIR CAUSES	124
Tangirqulov Gulom Baxtiyorovich	
EFFECTIVENESS OF ENVIRONMENTAL TAXES IN REDUCING CARBON EMISSIONS IN UZBEKISTAN: AN ECONOMETRIC APPROACH.....	129
Kuziboev Bekhzod Hamidovich	
WAYS TO DEVELOP QUALITY MANAGEMENT IN THE SILK INDUSTRY OF UZBEKISTAN'S ECONOMY	134
Bahriddinov Asror Rakhmatovich, Boltaev Nazarbek Narzullaevich	
STATE OF LENDING TO SMALL BUSINESS PROJECTS IN COMMERCIAL BANKS AND ITS ECONOMIC- STATISTICAL ANALYSIS.....	138
Nargiza Norqobilova Abdiqodirovna	
CONCEPTUAL DIRECTIONS FOR IMPROVING THE MECHANISMS OF ENSURING FINANCIAL STABILITY IN ENTERPRISES.....	143
Asomidinova Mohigulbonu Oybek kizi	
ORGANIZATION OF MANAGEMENT ACCOUNTING IN NON-STATE HIGHER EDUCATION INSTITUTIONS	148
Xojiboyev Muxiddin Shodimuxamedovich	
THE NATURE AND ESSENCE OF DIGITAL TRANSFORMATION PROCESSES IN MASS MEDIA ORGANIZATIONS.....	151
Sharipova Shahlo Istamovna	
COMPARATIVE ANALYSIS AND EXPERIMENTAL EVALUATION OF ALGORITHMS FOR RECOVERING MISSING (NAN) VALUES IN INFORMATION SYSTEM DATA	156
Yarmatov Sherzodjon Shokir oglu, Orifov Oxunjon Fazliddinzoda	
ANALYSIS OF THE STATE OF MARKETING MANAGEMENT IN MANUFACTURING ENTERPRISES	167
Musayeva Shoirazimovna	
IMPROVING LOAN PORTFOLIO QUALITY AND CREDIT RISK MANAGEMENT MECHANISMS	173
Turgunov Nodirbek Muminjanovich	
INNOVATION CAPABILITIES AND EXPORT PERFORMANCE: THE MEDIATING ROLES OF SUPPLY CHAIN INNOVATION AND ENTREPRENEURIAL ORIENTATION — EVIDENCE FROM UZBEKISTAN	177
Mukhammadyaminova Shakhzoda	
URBAN PLANNING OF TRANSPORT INTERCHANGE HUBS NEAR TUBERCULOSIS CARE FACILITIES IN UZBEKISTAN	183
Gabibova Irina Vagifovna, Abdumuminova Diyora Gayratovna	
ADAPTING INTERNAL AUDIT STANDARDS IN BUDGET ORGANIZATIONS TO PUBLIC PROCUREMENT PRACTICES.....	192
Meliboyev Askar Eshmuratovich	
ECONOMETRIC EVALUATION OF INVESTMENT EFFICIENCY IN KHOREZM REGION	197
Otajonov Umid Abdullayevich	
SCIENTIFIC AND PRACTICAL SIGNIFICANCE OF MODERN RECLAMATION AND GIS TECHNOLOGIES ON SALINE SOILS IN KARAKALPAKSTAN	205
Tajibaev Berdakh	
ISSUES REGARDING THE IMPLEMENTATION OF THE “TOLLING OPERATIONS” MODULE IN THE GOODS MOVEMENT MANAGEMENT SYSTEM UNDER THE CUSTOMS TERRITORY PROCESSING REGIME	212
Lutpullaev Shukrullo Kudratullaevich	

THE ROLE OF DIGITAL MARKETING IN ENHANCING TOURISM-RELATED BUSINESSES IN UZBEKISTAN Akmaljon Odilov	218
INTERNATIONAL TRENDS OF DIGITALIZATION IN CUSTOMS MANAGEMENT Radjapova Latofat Sardarovna	222
THE ROLE OF TAX POLICY IN THE TRANSITION TO A GREEN ECONOMY Dexkanova Shodiyona Kaxramon qizi	230
PRACTICES IN ENTERPRISE COST STRUCTURE MANAGEMENT AND DIRECTIONS FOR IMPROVEMENT Aymukhammedova Amina Kakajanovna	236
IMPROVING THE ECONOMIC EFFICIENCY OF CLOTHING MANUFACTURING ENTERPRISES IN UZBEKISTAN THROUGH DIGITAL TRANSFORMATION Axmedova Gaziza Azim kizi	242
RECONCEPTUALIZING BUSINESS INCUBATORS IN STARTUP ECOSYSTEMS: THEORETICAL FOUNDATIONS AND INSTITUTIONAL MECHANISMS Gafujon Usmanov	246
DEVELOPMENT OF MODERN MARKETING APPROACHES TO CUSTOMER RELATIONSHIP MANAGEMENT IN RETAIL ENTERPRISES Safarov Bakhtiyor Djurakulovich	257
MECHANISMS FOR EVALUATING AND IMPROVING THE EFFECTIVENESS OF MARKETING STRATEGIES IN THE PUBLIC TRANSPORT SECTOR Berdiyev Temur Azamatovich	263
THE INFLUENCE OF HYDRODYNAMIC ASPECTS OF GROUNDWATER LEVEL RISE ON URBAN WATERLOGGING B.D. Abdullaev, B.R. Nasibov, Sh.T. Irgashev, D. Abdullaev	268
BASIC INFORMATION MODEL OF A DIGITAL OBJECT Gulyamov Shukhrat Mannapovich, Karakhanova Alsu Muratalievna, Keldiyorov Sirojiddin Tura ugli, Zayniddinova Zebiniso Akmalovna	277
COMPARATIVE LIFE CYCLE AND TECHNO-ECONOMIC ANALYSIS OF SOLAR PANEL MATERIALS FOR SUSTAINABLE PHOTOVOLTAIC SYSTEMS Urishev Omadjon, Kushakova Sarvinoz, Kamolboyev Sirojbek	281
PRIORITY DIRECTIONS FOR FORMING ECOLOGICALLY ORIENTED MANAGEMENT IN CONSTRUCTION INDUSTRY ENTERPRISES Kholov Hamza Tajiddinovich	294
INVESTIGATION OF GERMANIUM EXTRACTION TECHNOLOGY FROM TECHNOGENIC METALLURGICAL WASTE Yormatov Dostonbek, Shodiyev Abbos, Muhammadiyev Elbek	301
MECHANISMS FOR IMPROVING RESOURCE EFFICIENCY AND OPTIMIZING PRODUCTION COSTS IN THE CONSTRUCTION MATERIALS INDUSTRY Utbasarov Doniyorjon Bakhtiyarovich	309
THEORETICAL, PRACTICAL AND METHODOLOGICAL PROBLEMS OF AUDITING THE ACTIVITIES OF ECONOMIC ENTITIES ON THE BASIS OF INTERNATIONAL STANDARDS Mirzaeva Sabina Khushnudovna, Khaydarova Dildora Djakhongirovna	318
THE IMPACT OF DIGITAL AND INNOVATIVE TECHNOLOGIES ON WOMEN'S LABOR IN INDUSTRIAL ENTERPRISES OF UZBEKISTAN UNDER INDUSTRY 4.0 Doniyorova Zukhrabonu Alisher qizi	322
LEVEL OF ENSURING FOOD SECURITY: IMPLEMENTATION MECHANISMS AND INSTRUMENTS Sodiqjon Qodirovich Mattiyev	328
DIGITAL TRANSFORMATION, ECONOMIC EFFICIENCY, AND LOCALIZATION POLICY OF THE PUBLIC PROCUREMENT SYSTEM Turabov Sarvar Abdumalikovich	334
TA'LIM XIZMATLARI BOZORIDAGI INNOVATSIYALAR IQTISODIY XAVFSIZLIKNI TA'MINLASH VOSITASIDA Bozorova Madina Raxmat qizi	339

PROJECT-ORIENTED ESP32 IOT CURRICULUM WITH A SHARED-RESOURCE LABORATORY MODEL: DESIGN, IMPLEMENTATION, AND LESSONS LEARNED	344
Ulugbek Tursunaliyev, Lazizbek Yusupov	
FIVE-CRITERION METHODOLOGY OF INTERNAL CONTROL ENVIRONMENT ASSESSMENT IN TEXTILE INDUSTRY ENTERPRISES	353
Babakulova Matluba Kurbannazarovna	
THE EFFICIENCY OF EDUCATION-INDUSTRY INTEGRATION IN THE CONTEXT OF THE KNOWLEDGE ECONOMY.....	357
Uzaydulloyev Sherzod Shukurullayevich	
MECHANISMS AND DIRECTIONS FOR DEEPENING REGIONAL INTEGRATION PROCESSES IN CENTRAL ASIA.....	361
Akbarova Kamola Akmaljonovna	
EVALUATION OF THE EFFECTIVENESS OF MANAGEMENT SYSTEMS IN HEALTHCARE INSTITUTIONS	368
Saidov Suhrob Shodmonovich	
IMPROVING INVESTMENT ATTRACTION MECHANISMS IN UZBEKISTAN'S SERVICE SECTOR: BARRIERS, OPPORTUNITIES, AND POLICY RECOMMENDATIONS.....	371
Shermatov Axror Abdixakimovich	
METHODOLOGICAL FOUNDATIONS FOR FORMING CUSTOMS RISK PROFILE INDICATORS BASED ON MATHEMATICAL AND STATISTICAL METHODS	377
Niyazov Sherzod Shovkat ugli	
AN INSTITUTIONAL GOVERNANCE FRAMEWORK FOR CRYPTO-ASSET REGULATION: ADDRESSING LEGAL UNCERTAINTY IN DIGITAL FINANCIAL SYSTEMS	385
Iminokhunov Abdukokhor A., Khakimov Abdurakhmon Mukhammad-Ali ugli	
THEORETICAL AND ORGANIZATIONAL-ECONOMIC FOUNDATIONS OF THE SERVICE SECTOR	396
Kurbanova Rahima Jamshedovna	
REGIONAL ASSESSMENT OF THE OPENNESS OF SPECIAL ECONOMIC ZONES IN UZBEKISTAN BASED ON A SYNTHETIC INDICATOR.....	401
Anvarkhonov Abdulatifkhon Jamshidkhon ugli	
IMPROVEMENT OF THE REGIONAL INVESTMENT ENVIRONMENT ASSESSMENT CRITERIA AND INDICATORS SYSTEM.....	407
Maxmudov Jasurbek Ergashevich	
ANALYSIS OF FOREIGN INVESTMENT ATTRACTION PRACTICES IN THE NATIONAL ECONOMY.....	412
Ochilov Bobur Bakhtiyor ugli	
ASSESSMENT OF SOURCES OF EQUITY FORMATION IN JOINT-STOCK COMPANIES AND THE EFFECTIVENESS OF THEIR USE.....	421
Savinova Galina Anatolevna	
DIGITAL MARKETING INTEGRATION, KPI ARCHITECTURE AND CAUSAL EVALUATION OF ENTERPRISE COMPETITIVENESS IN EMERGING MARKETS: A CONCEPTUAL-METHODOLOGICAL FRAMEWORK FOR UZBEKISTAN	429
Bakhtiyor Ruziev Eshmuminovich	
IMPROVING FOREIGN EXCHANGE RISK MANAGEMENT PRACTICES IN COMMERCIAL BANKS OF UZBEKISTAN	434
B.K. Tugalov	

IMPROVING FOREIGN EXCHANGE RISK MANAGEMENT PRACTICES IN COMMERCIAL BANKS OF UZBEKISTAN



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Abstract: Currency risk is defined as the risk of bank losses due to exchange rate fluctuations and is one of the main types of banking risks. The liberalization of currency relations in Uzbekistan, which began in 2017, has led to increased attention to currency risk management in the country's commercial banks. The article analyzes the current state of practice of currency risk management in commercial banks of Uzbekistan and develops scientific proposals aimed at improving this practice.

Key words: commercial bank, currency risk, exchange rate, currency position, spot, forward, swap.

Annotatsiya: Valyuta riski valyuta kurslarining o'zgarishi natijasida bankning zarar ko'rish xavfi sifatida talqin qilinadi va bank risklarining asosiy turlaridan biri hisoblanadi. O'zbekistonda 2017-yildan boshlab boshlangan valyuta munosabatlarini liberallashtirish respublika tijorat banklarida valyuta riskini boshqarish masalasining dolzarbligini oshirdi. Maqolada O'zbekiston tijorat banklarida valyuta riskini boshqarish amaliyotining zamonaviy holati tahlil qilingan hamda ushbu amaliyotni takomillashtirishga qaratilgan ilmiy takliflar ishlab chiqilgan.

Kalit so'zlar: tijorat banki, valyuta riski, valyuta kursi, valyuta pozitsiyasi, spot, forward, svop.

Аннотация: Валютный риск трактуется как опасность потерь банка в результате колебания обменных курсов валют и являются одним из основных видов банковских рисков. Либерализация валютных отношений в Узбекистане, начатое с 2017 года привело к повышению вопроса управления валютным риском в коммерческих банках республики. В статье анализировано современное состояние практике управления валютным риском в коммерческих банках Узбекистана и разработаны научные предложения, направленных на совершенствование данную практику.

Ключевые слова: коммерческий банк, валютный риск, валютный курс, валютная позиция, спот, форвард, своп.

INTRODUCTION

According to the Decree of the President of the Republic of Uzbekistan "On Priority Measures for the Liberalization of Foreign Exchange Policy," the exclusive use of market mechanisms in determining the exchange rate of the national currency against foreign currencies, enhancing the role of market instruments in the utilization of foreign exchange resources, creating equal competitive conditions in the foreign exchange market for all business entities, implementing a strict monetary policy aimed at ensuring the stability of the national currency through the active and flexible use of its instruments, developing the government securities market, as well as introducing open market operations and liquidity provision operations for banks secured by government securities into practice, are identified as priority directions of the state economic policy in the field of liberalization of foreign exchange relations [1]. This necessitates the improvement of foreign exchange risk management practices in the commercial banks of the republic.

REVIEW OF LITERATURE ON THE SUBJECT

According to F. Sytina and E. Kayasheva, there are four types of foreign exchange risks:

- translation foreign exchange risk;
- transaction foreign exchange risk;
- operational foreign exchange risk;
- hidden foreign exchange risk [2].

According to T. Struchenkov, foreign exchange risks arise during foreign trade, credit, investment, settlement, and conversion operations, as well as transactions on stock and commodity exchanges, due to changes in the value of assets, liabilities, monetary claims, and obligations denominated in foreign currency as a result of exchange rate fluctuations [3].

According to D. Piskulov, foreign exchange risk frequently arises when commercial banks conduct international settlements and international foreign exchange operations. In particular, such risk may emerge during the execution of a foreign exchange contract if the counterparty faces default. In this case, foreign exchange risk becomes a form of credit risk. In addition, so-called settlement risk may arise as a result of payments conducted across different time zones. During the period between the first and the second payment, the counterparty may enter a state of default. Furthermore, interest rate risk may occur during foreign exchange operations if there is a mismatch in the maturity periods of foreign currency positions [4].

H. van Greuning argues that revaluation risk arises when a bank's foreign currency positions are revalued into the national currency or when a parent company periodically consolidates financial statements, while operational foreign exchange risk reflects the impact of exchange rate changes on foreign accounts receivable and payable, namely on the difference between the value at which they are recorded in the local currency in the bank's financial statements [5].

M. Labudeva states that the Value at Risk (VaR) method of quantitative assessment enables a more accurate determination of potential losses arising from foreign exchange risk. At the same time, various criteria for the qualitative assessment of foreign exchange risk necessitate its classification into the following groups:

- minimal foreign exchange risk;
- medium foreign exchange risk;
- critical foreign exchange risk;
- unacceptable foreign exchange risk [6].

According to N. Jumayev, the instability of deposit and lending interest rates in the republic negatively affects the stability of forward exchange rates, since deposit and lending interest rates are factors determining the size of premiums and discounts. Premiums and discounts, in turn, are the only factors distinguishing the forward exchange rate from the spot exchange rate [7].

According to T. Bobakulov and U. Abdullayev, accounting for unrealized losses on forward operations has significant practical importance in the management of foreign exchange risk in commercial banks. This is explained by the fact that, in banking practice, it is quite common for forward contracts either not to be executed at all or to be executed with delays. This is due to the possibility that one of the parties to the forward contract may become insolvent upon the expiration of the contract term [8].

RESEARCH METHODOLOGY

The research methodology is based on the use of statistical data from the Central Bank of the Republic of Uzbekistan, the Republican Currency Exchange, and commercial banks for 2020–2025. The study employed comparative, dynamic, and structural analysis methods, as well as an assessment of exchange rate volatility and the structure of foreign exchange operations to determine the level of foreign exchange risk within the banking system.

ANALYSIS AND RESULTS

The level of foreign exchange risk in commercial banks directly depends on the volatility (fluctuation) of the nominal exchange rate of the national currency and foreign currencies (Figure 1).

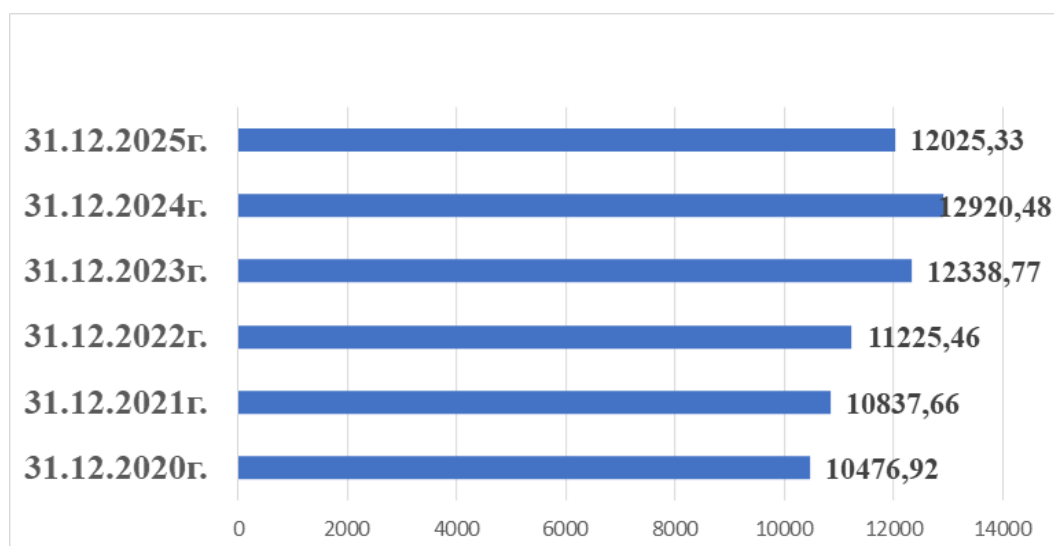


Figure 1. Nominal exchange rate of the national currency — the soum against 1 US dollar, in soums¹

As can be seen from Figure 1, during 2020–2025, the volatility level of the national currency of Uzbekistan against the US dollar remained relatively high (14.8%).

One of the important factors affecting the level of foreign exchange risk in commercial banks is the degree of diversification of foreign exchange reserves (Table 1).

Table 1. Volume of Foreign Exchange Operations on the Republican Currency Exchange and Their Currency Structure²

Indicators	2020	2021	2022	2023	2024
Volume of foreign exchange operations, trillion soums	266.0	217.9	338.3	458.0	466.6
Share of the US dollar in the total volume of foreign exchange operations, %	69.1	98.8	99.9	99.9	99.2
Share of the euro in the total volume of foreign exchange operations, %	8.9	0.1	0.1	0.1	0.3

As can be seen from the data presented in Table 1:

- in 2021–2024, the volume of foreign exchange operations on the Republican Currency Exchange showed an upward trend;
- in 2021–2024, transactions involving the US dollar accounted for an exceptionally high share of the total volume of foreign exchange operations. This clearly demonstrates the insufficient diversification of the foreign exchange reserves of business entities and commercial banks;
- in 2021–2024, foreign exchange operations involving the euro accounted for a very low share of the total volume of foreign exchange operations (Table 2).

Table 2. Structure of Foreign Exchange Operations of the National Bank for Foreign Economic Activity, in percentages³

Types of foreign exchange operations	2020	2021	2022	2023	2024
Spot operations	96.3	100.0	98.7	95.4	93.2
Forward and swap operations	3.7	0.0	1.3	4.6	6.8
Total foreign exchange operations	100.0	100.0	100.0	100.0	100.0

As can be seen from the data presented in Table 2:

- in 2020–2024, spot operations accounted for a very high share of the total volume of foreign exchange operations of the National Bank for Foreign Economic Activity;

1 The figure was compiled by the author based on statistical data from the Central Bank of the Republic of Uzbekistan.

2 Source: compiled by the author.

3 Source: compiled by the author.

- in 2021, forward foreign exchange operations and swap operations were absent from the total volume of foreign exchange operations of the National Bank for Foreign Economic Activity.

CONCLUSIONS AND SUGGESTIONS

We have formulated the following conclusions regarding foreign exchange risk management in commercial banks:

- foreign exchange risks arise during foreign trade, credit, investment, settlement, and conversion operations, as well as transactions on stock and commodity exchanges due to changes in the value of assets, liabilities, monetary claims, and obligations denominated in foreign currency as a result of exchange rate fluctuations;

- revaluation risk arises when a bank's foreign currency positions are revalued into the national currency or when a parent company conducts periodic consolidation of financial statements, while operational foreign exchange risk reflects the impact of exchange rate changes on foreign accounts receivable and payable, namely the difference between the value at which they are recorded in the local currency in the bank's financial statements;

- the instability of deposit and lending interest rates in the republic negatively affects the stability of forward exchange rates;

- in the management of foreign exchange risk in commercial banks, accounting for unrealized losses on forward operations has important practical significance, since in banking practice it is quite common for forward transactions either not to be executed at all or to be executed with delays.

In our opinion, the following measures should be implemented to improve foreign exchange risk management practices in commercial banks:

It is necessary to reduce the volume of open foreign currency positions of commercial banks through the development of forward operations, by ensuring quantitative balance in spot transactions, and by introducing currency options and futures operations into banking practice.

It is necessary to reduce the level of foreign exchange risk in spot operations by improving default management in the spot foreign exchange market.

In the spot foreign exchange market, if a dealer fails to fulfill obligations, the dealer is recognized as a defaulting dealer, and the following procedures are carried out:

- the dealer is given the opportunity to independently fulfill its net obligations;
- in order to transfer the position related to the unfulfilled obligation, the Republican Currency Exchange of the Republic of Uzbekistan concludes an overnight swap transaction on behalf of the defaulting dealer and at the expense of its net claim;

- positions of bona fide participants are closed through opposite transactions at prices aimed at minimizing overall damage to the system;

- if the funds of the defaulting participant are insufficient, the reserve funds of the clearing center are utilized, including contributions from other participants and the capital of the exchange itself.

The exchange blocks and liquidates the available assets and guarantee fund (stress collateral) of the debtor in order to cover the debt owed to the counterparty of the transaction.

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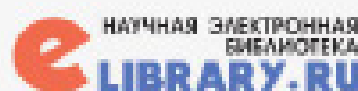
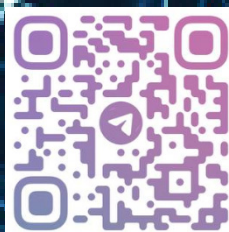
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