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Article

The Role of Interbank Competition in Ensuring the Stability of the Banking System

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Annotation. This article explores the pivotal role of interbank competition in ensuring the stability and sustainability of the banking system. In the modern financial landscape, the dynamics of interbank competition significantly influence banks' operational efficiency, liquidity management, and overall financial stability. The study investigates how competitive pressures drive banks to innovate, diversify their product offerings, and optimize their risk management strategies. By enhancing customer satisfaction and promoting financial inclusivity, interbank competition contributes to a more robust banking ecosystem. However, excessive competition may lead to riskier lending practices, reduced profit margins, and heightened systemic risks.

Key words: competition, interbank competition, bank capital, loan portfolio, bank stability, bank profitability, bank liquidity.

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Introduction

The positive changes in the competitive environment in the banking system of our country in recent years have played an important role in increasing the financial stability of banks and further improving the number and quality of banking services. The increasing level of competition between banks creates the need for banks to offer more favorable conditions for loans, deposits and other financial products in order to attract customers. This, in turn, contributes to improving the quality of service and innovation in the banking sector, more efficient use of available resources, optimization of their costs, and increased efficiency of banking business.

In recent years, the number of banks in our country has increased, digital technologies are being widely introduced into the banking system, as well as the number of branches and divisions of foreign banks, the expansion of the scope of reforms aimed at further liberalizing the banking system, and the transformation processes of banking activities are reaching a new level, which is leading to further increased competition between banks.

Nevertheless, the fact that the level of competition between state-owned banks and other banks in our country is somewhat limited, financial markets are underdeveloped, certain privileges remain in the banking system, the general level of financial literacy of the population, the low level of profitability in state-owned banks, the increasing volume of problem assets, and other factors require the consistent continuation of work to ensure the competitiveness of the country's banking system.

Literature review.

The evolution of theoretical views on interbank competition creates the need to study the role and importance of competition in the banking system in more depth. Asli Demirguc-Kunt and Harry Huizinga in their article examine interbank competition[1]. In this work, they analyze the interaction of two factors - the state deposit insurance system and interbank competition. They conclude that interbank competition can increase market discipline and reduce risks in the banking system. They argue that a high level of competition between banks encourages more careful management of resources and sound banking practices, as banks must compete for customer trust and the stability of their business.Xavier Vives "emphasizes that interbank competition contributes to the efficiency of the banking system and reduces the level of monopolization, increases innovation and the quality of services provided" [2].

Both approaches examine the relationship between interbank competition, financial stability, and banking system efficiency. They emphasize the importance of competition in the banking sector and its positive impact on the efficiency and stability of the banking system.

Xavier Vives also examines issues related to market concentration and its impact on interbank competition and stability. He discusses the various mechanisms by which competition affects market structure and banking performance. He puts forward ideas about the need for effective regulation to maintain a balance between competition and stability.

In our opinion, Xavier Vives's focus on the relationship between competition and stability is explained by the need to take these factors into account when formulating and monitoring effective governance policies in the banking sector.

Uzbek economist explains that "interbank competition is usually understood as competition that arises between commercial banks in terms of attracting resources and providing financial services to customers." [3]

According to "interbank competition consists primarily of a struggle for clients. The more clients a bank has and the more reputable it is, the more likely it is to advance its interests." [4].

In our opinion, competition in commercial banks will be more pronounced not only in terms of attracting more customers, but also in the struggle for resources, loans, and other financial resources.

Local scientists in his scientific research, paid special attention to modern ways to increase the level of bank capitalization in order to ensure the stability of the banking system [5,6,7].

Another economist, emphasized that "bank competition should be viewed as a struggle between financial market participants, in particular credit institutions, for the sale of loans, deposits and other banking products, and should be evaluated as a process that requires constant research." [8]

According to some foreign economists, "interbank competition can increase the risky activities of banks, as banks seek to attract more customers by offering favorable conditions to their customers, which can increase their risky assets. On the other hand, competition encourages banks to work more efficiently and introduce innovative approaches, which has a positive effect on their stability" [9].

Another foreign scholar argues that "As market competition intensifies, banks may be forced to lower lending interest rates and increase deposit rates to attract customers, which may reduce their profit margins and affect their financial strength[10]."

In general, the need to ensure the stability of commercial banks in the conditions of interbank competition is such that, as a result of entering into competition, banks will be able to analyze their strengths and weaknesses, develop strategies to further increase their role and share in the banking services market, and increase their opportunities to further strengthen innovative approaches in interactions with customers[11].

Research methodology.

In preparing the article, utilizes a mixed-methods approach to investigate the role of interbank competition in ensuring the stability of the banking system. Quantitative data is collected from financial statements, regulatory reports, and international financial databases to analyze key indicators such as market concentration, profitability, liquidity, and credit risk among banks. Econometric models, including panel data regression and stress-testing scenarios, are employed to examine the relationship between competition and financial stability. Additionally, qualitative insights are gathered through expert interviews with banking regulators, financial analysts, and bank executives to understand strategic responses to competitive pressures. Comparative analysis is conducted using case studies from developed and emerging markets, focusing on the impact of regulatory frameworks on competition dynamics. Data triangulation is used to validate findings, ensuring reliability and accuracy. This comprehensive methodological approach provides a robust foundation for assessing how interbank competition influences banking stability and offers practical implications for policymakers and financial institution.

Analysis and results.

Interbank competition is indeed an important factor in the banking sector. It refers to the competitive environment and dynamics between banks in the interbank market, where banks borrow and raise funds from each other. There are several key aspects that indicate the importance of interbank competition:

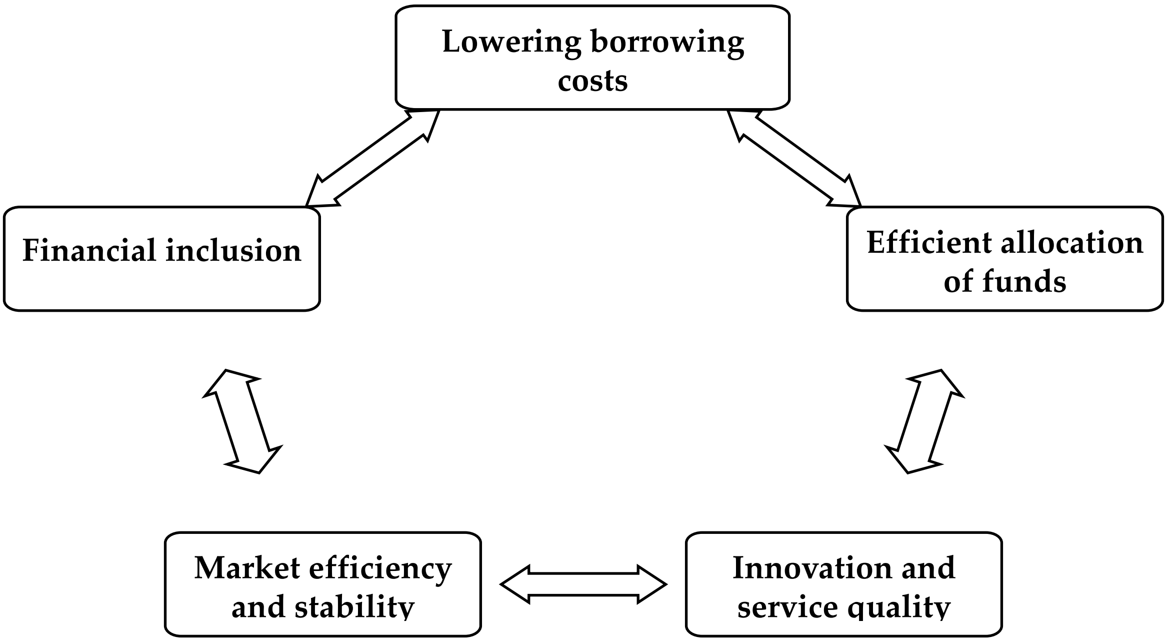

Figure 1. Key aspects of interbank competition [12]

1. Lower borrowing costs: Stronger competition between banks can lead to lower borrowing costs for banks. As banks compete to attract funds from other banks, they can offer

more favorable interest rates on interbank loans. This ultimately benefits the borrowing bank, as it can borrow funds at a lower cost, allowing it to offer more favorable lending rates to businesses and individuals.

2. Efficient allocation of funds: Interbank competition encourages banks to allocate their funds to the most productive and creditworthy borrowers. Banks seek to lend to reliable and creditworthy counterparties to optimize their profits and maintain their reputation. This competitive pressure helps to allocate funds more efficiently and helps to lend to sectors with strong growth potential.

3. Innovation and service quality: Interbank competition can stimulate innovation and improve service quality in the banking sector. To demonstrate their advantages and attract more customers, banks strive to introduce innovative financial products, advanced technological solutions, and improved customer service. These competitive innovations increase the availability of more products and services to customers, enabling them to meet their changing needs..

4. Market efficiency and stability: A healthy interbank competition environment allows for increased market efficiency by more accurately assessing market conditions in terms of resource mobilization and lending practices. When banks compete, they primarily strive to operate efficiently, manage risks effectively, and maintain financial stability. This helps create a strong and stable banking industry that is better able to withstand various economic shocks.

5. Financial Inclusion: Interbank competition promotes financial inclusion by encouraging banks to expand their services to underserved markets. In a competitive environment, banks can serve to expand new customer segments by offering tailored products and expanding their geographic reach. This helps to further improve access to banking services for previously underserved individuals and businesses.

Table 1

Pros and cons of interbank competition [13]

t/r	Positive aspects	Negative aspects
	Competition helps banks operate more efficiently, reduce costs, and offer better services and products to their customers	Intense competition can lead banks to take greater risks to maintain or increase their market share, which can undermine the stability of the banking system..
	Competition helps banks operate more efficiently, reduce costs, and offer better services and products to their customers	Excessive competition can reduce banks' profitability, undermine their stability, and increase the likelihood of banking crises.
	Competition lowers the cost of banking services for consumers and businesses.	If competition is focused solely on price, banks may find themselves undercutting their margins, making them vulnerable to market fluctuations.
	Stronger competition will encourage banks to serve a wider range of customers, thereby improving access to financial services in the economy.	Banks may relax lending standards to attract more customers, which could lead to an increase in problem loans and financial instability.

Efforts to promote interbank competition often involve regulatory measures such as ensuring transparency, reducing barriers to entry, and enforcing fair competition practices. Striking a balance between healthy competition and risk management is essential to ensuring the stability and integrity of the banking system.

TABLE 1

MAIN INDICATORS OF THE BANKING SYSTEM OF THE REPUBLIC OF UZBEKISTAN [14]

Indicator name	01.01. 2021 y.	01.01. 2022 y.	01.01. 2023 y.	01.01. 2023 y.	01.01. 2023 y.
GDP	580 203,2	734658,3	888342,5	1000000,2	1450000,3
Bank assets, billion soums	366 121	444 922	556746	652157,0	769330,0
Assets to GDP ratio, percent	63,1	60,6	62,7	65,2	53,1
Loans, billion soums	276 975	326 386	390049	471406,0	533121,0
Loans to GDP ratio, percent	47,7	44,4	43,9	47,1	36,8
Total deposits attracted, billion soums	114747	156 190	216738	241687,0	308692,0
Deposits to GDP ratio, percent	19,8	21,3	24,4	24,2	21,3
Total capital, billion soums	58162	70191	79565	97079,0	114792,0
Total capital to GDP ratio, percent	10,0	9,6	9,0	9,7	7,9

Analyzing the current state of the banking system of our country, we can see that over the past 5 years, all the main indicators of the country's commercial banks have been growing. In particular, the assets of commercial banks increased by almost 2.1 times in 2020-2024, while their share in GDP decreased by 10 percent. The growth of bank assets contributes to a more efficient allocation of capital in the economy, while creating more opportunities for the provision of loans and other financial services. Also, if banks can properly manage the risks associated with their assets, ensuring their growth, this will make a positive contribution to ensuring financial stability in the country. The growth of bank assets will also allow the bank's loan portfolio to grow accordingly. A positive trend in the loan portfolio is being observed in the banking system of our country. The share of bank loans in GDP decreased from 47.7 percent in 2020 to 36.8 percent in 2024. This situation indicates the need to increase the role of the country's banking system as the "locomotive" of the economy.

The growth of commercial bank assets and the stable growth of credit investments are of great importance in the stability of attracted funds, including bank deposits. During the analyzed period, a trend of growth in the banking system's deposits in absolute terms was observed. For example, in 2020, bank deposits amounted to 114.7 trillion soums, while in 2024 they amounted to 308.7 trillion soums, which is an increase of more than 2.7 times over the past 5 years. Also, the bank's capital, which is one of the important indicators characterizing the financial stability of banks, has also shown a steady growth trend. The capital of commercial banks in our country has increased by 2 times over the past 5 years, amounting to 114.8 trillion soums at the end of 2024. A decrease in bank capital relative to GDP was observed between 2020 and 2024. International experts recognize that if the ratio of commercial banks' capital to the country's GDP is above 6 percent, the country's banking system is at a normal level of capitalization.

Table 3

Volume of regulatory capital, deposits and loans of commercial banks of the Republic of Uzbekistan, (at the end of the year, trillion soums) [15]

Indicators	Years					Change in 2024 compared to 2020
	2020	**2021**	**2022**	**2023**	**2024**	
Regulyativ kapital	58 162	70 191	79565	97079,0	114792,0	2,0
Depozitlar	114 747	156 190	216738	241687,0	308692,0	2,7
Kreditlar	276 975	326 386	390049	471406,0	533121,0	1,9

Increasing regulatory capital usually has a positive effect on the financial soundness of banks, as it increases their ability to withstand losses and reduces the likelihood of bankruptcy. In the Republic of Uzbekistan, as in other countries, the requirements for the regulatory capital of commercial banks are being increased in order to strengthen the stability of the financial system.

Based on the changes made to the relevant regulatory documents of the Central Bank of the Republic of Uzbekistan, the minimum amount of capital of commercial banks is set at five hundred billion soums from January 1, 2025.

Deposits are the main source of funds for banks to lend and are an important indicator of the confidence of the population and enterprises in the banking system. An increase in the level of deposits usually helps to stabilize and increase the liquidity of the bank, which also has a positive effect on its stability. At the same time, a significant increase in the share of short-term deposits can increase liquidity risk, as this requires the bank to be highly prepared to return funds to depositors. [16].

While lending by banks is the main source of their income, it also poses significant risks, including credit risk, interest rate risk (changes in interest rates that can affect a bank's margins), and concentration risk (large loans to a few borrowers increase a bank's exposure to its financial position). Effective credit risk management is a key factor in the stability of the banking system.

The analysis shows that the capital, credit and deposit base of our country's banking system are showing a steady growth trend. However, the ratio of bank deposits to loans in our country remains low. This situation may negatively affect the resource potential of the country's banking system. Because in conditions of interbank competition, competition between commercial banks in the financial resources market leads to an increase in the cost of resources and a decrease in the effectiveness of banks' interest rate policy. This may lead to a decrease in the profitability and profitability of commercial banks.

Therefore, commercial banks are required to use resources rationally in the context of interbank competition, while also being able to properly manage factors affecting their financial stability.

The ultimate goal of the strategies adopted by the government of our country to reform the banking system is, first of all, aimed at further increasing the stability of the country's banking system by creating an environment of pure competition between commercial banks.

On May 12, 2020, the Decree of the President of the Republic of Uzbekistan No. PF-5992 “On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025” was adopted, which states:

Increasing the share of assets of banks without state ownership in the total assets of the banking system from the current 15 percent to 60 percent by 2025;

Increasing the share of banks' liabilities to the private sector in the total volume of banks' liabilities from the current 28 percent to 70 percent by the end of 2025;

By 2025, attract at least three strategic foreign investors with the necessary experience, knowledge and reputation to the capitals of at least three banks with a state share;

Phased privatization of state shares in Ipoteka-bank JSCB, Uzsanoatqurilishbank JSCB, Asaka JSCB, Aloqabank JSC, Qishloq Qurilish Bank JSCB and Turonbank JSCB with the support of international financial institutions, including their institutional transformation (transformation of their activities) at the first stage, and the sale of a package of state shares at the second stage;

The tasks set include creating equal competition conditions in the financial market, implementing lending solely on market terms, reducing banks' dependence on state resources, modernizing the provision of banking services, creating an effective infrastructure for banks and automating their activities, as well as increasing the efficiency of the banking system by gradually eliminating functions that are not inherent in the activities of banks.

However, analytical data show that the role of state-owned commercial banks in the banking system and their share in the banking financial services market remain high.

Table 4

Information on comparative indicators of the banking system [17]

Indicators	01.01.2024 y.				01.01.2025 y.			
	Assets	Liabilites	Loans	Depozis	Assets	Liabilites	Loans	Depozis
Total	652157	555078	471355	241686	769330	654538	533122	308692
State share in existing banks, trillion soums	441562	378483	333219	124305	503187	433012	366731	154511
Other banks, trillion soums	210595	176595	138136	117381	266143	221526	166391	154181
Share of banks with state ownership, in percent	67,7	68,2	70,7	51,4	65,4	66,2	68,8	50,1
Share of other banks, in percent	32,3	31,8	29,3	48,6	34,6	33,8	31,2	49,9

Analyzing the data in the table, it is noticeable that the share of banks with a state share in the banking services market in our country's banking system is significantly higher. In 2023, these banks accounted for 67.7 percent of the banking system's assets, 68.2 percent of liabilities, 70.7 percent of loans, and 51.4 percent of deposits. Although the interbank competition environment in the banking services market in 2024 showed positive trends, the share of commercial banks with a state share remains high.

The share of the five largest state-owned banks (National Bank of Uzbekistan, Uzsanoatqurilishbank, Asakabank, Xalqbank, Agrobank) in the banking system's assets decreased from 60.9% to 51.2%. The share of other state-owned banks increased from 18% to 24%, while the share of private banks increased from 21.5% to 24.7%.

The share of the five largest banks in the total loan portfolio decreased from 64% to 51%. The share of private banks increased from 16.6% to 19.8%, while the share of other banks with state ownership reached 27%.

In the deposit market, competition between private banks is stronger than competition between banks with a state share and private banks. UzKDB's share in this market decreased from 8.6% to 3.6%, while Kapitalbank increased its share from 4.8% to 10.9%. Hamkorbank's share of deposits decreased from 5.5% to 3%.

The increased competition for deposits is also reflected in the attractiveness of interest rates on term deposits. For example, the average interest rate on term deposits in the national currency was 20% in June 2024, while the average interest rate on loans in soums was 23.6%.[18].

In a competitive environment, banks are forced to constantly improve their services, attract customers and offer them more favorable conditions. This serves to increase the efficiency of the banking system, improve access to financial services for the population and businesses, as well as increase the level of financial literacy of market participants.

In addition, interbank competition helps to increase the financial stability of individual banks and the banking system as a whole. Competition forces banks to take a more responsible approach to risk management, to ensure adequate levels of liquidity and capital, which reduces the likelihood of systemic crises.

Conclusions

Interbank competition plays a key role in the banking system and affects its stability. In order to further improve the interbank competition environment in the country and ensure the stability of the banking system, we believe that it is necessary to pay attention to the following:

1. Develop and implement a strategy to improve competition in the banking sector, including strengthening antitrust control and ensuring a level playing field for all market participants.

2. Improving the regulatory framework to provide a more favorable environment for interbank competition and increased investment attractiveness.

3. State support for the development of technological innovations to improve the quality and convenience of banking services.

4. Implement financial inclusion programs to ensure access to financial services for all segments of the population.

5. Ensuring transparency of banking activities and improving control mechanisms in order to create a fair and clean competitive environment.

These measures will help address issues related to interbank competition in the Uzbek banking system and contribute to the development of a more competitive and inclusive financial system.

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