

FUNCTIONS OF CENTRAL BANK AND COMMERCIAL BANKS

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Abstract: This article discusses the major functions of central banks and commercial banks, their interrelation in maintaining economic stability, and their roles in promoting economic growth. It explores the mechanisms through which central banks regulate money supply, interest rates, and inflation, while commercial banks serve as intermediaries that mobilize savings and provide loans to stimulate production and trade.

Key words: Central Bank, Commercial Bank, monetary policy, financial stability, banking system, economic growth

Introduction:

The financial system of every country operates through two main types of institutions: the central bank and commercial banks. Together, they form the backbone of a nation's monetary and financial structure. The central bank acts as the monetary authority responsible for implementing monetary policy and maintaining price stability, while commercial banks directly interact with the public by providing deposit, credit, and payment services. Understanding their respective roles and interrelations is crucial to appreciate how monetary stability and economic development are achieved.

I. ROLE AND FUNCTIONS OF CENTRAL BANK

The central bank is the supreme monetary institution of a country. It performs functions that aim to control the supply of money, regulate the financial system, and maintain overall economic stability. It formulates and implements monetary policy to control inflation, stabilize prices, and ensure sustainable economic growth. By regulating interest rates and managing the supply of money, the central bank influences investment, consumption, and employment levels across the country. It also acts as the government's banker, managing national debt, issuing treasury bills, and financing public projects when necessary. Through foreign exchange management, the central bank stabilizes the national currency and promotes balanced trade with other countries. In times of crisis, it serves as a lender of last resort, providing liquidity support to financial institutions to prevent collapse. Furthermore, it supervises and regulates commercial banks, ensuring they operate safely and maintain public confidence. By gathering

and analyzing financial data, the central bank also advises the government on fiscal and economic strategies. In essence, the central bank is the cornerstone of economic governance, shaping policies that keep the nation's financial system strong and resilient.

The key functions include:

1. **Issuer of Currency:** The central bank has the sole authority to issue the national currency, which ensures uniformity and control over money supply.
2. **Banker to the Government:** It manages the government's banking transactions, public debt, and fiscal operations.
3. **Banker's Bank:** The central bank provides financial services to commercial banks, including lending and reserve management.
4. **Lender of Last Resort:** During financial crises, it provides liquidity to commercial banks to prevent banking collapse.
5. **Controller of Credit:** It uses monetary tools such as open market operations, discount rate, and reserve requirements to influence credit supply.
6. **Maintenance of Foreign Exchange Stability:** The bank manages exchange rates and foreign reserves to ensure stability in international trade.

II. ROLE AND FUNCTIONS OF COMMERCIAL BANKS

Commercial banks play a vital role in the economic system by directly interacting with individuals, firms, and the government. They act as financial intermediaries by mobilizing savings from the public and lending them to those in need of funds.

The primary functions of commercial banks include:

1. **Accepting Deposits:** Banks collect savings from individuals and institutions in various forms like savings, current, and fixed deposits.
2. **Providing Loans and Advances:** They extend credit to businesses and individuals, supporting production, investment, and consumption.
3. **Facilitating Payments:** Commercial banks offer services like cheques, debit/credit cards, and online transfers to simplify transactions.
4. **Credit Creation:** By issuing loans beyond their cash reserves, banks expand the money supply in the economy.
5. **Agency Functions:** They perform functions such as bill collection, fund transfers, and payment of dividends on behalf of customers.
6. **Investment Services:** Many banks also invest in securities and provide portfolio management to enhance profitability.

III. RELATIONSHIP BETWEEN CENTRAL AND COMMERCIAL BANKS

The relationship between central and commercial banks is based on control, regulation, and cooperation. The central bank ensures the stability of the banking system by regulating the operations of commercial banks.

Commercial banks, on the other hand, implement monetary policies through their lending and deposit operations. Thus, their relationship is both hierarchical and complementary — the central bank provides the framework, and commercial banks execute it in the market.

IV. IMPORTANCE IN ECONOMIC DEVELOPMENT

Both central and commercial banks contribute to economic development in unique but interconnected ways. The central bank maintains monetary stability, controls inflation, and supports sustainable growth. Commercial banks finance infrastructure, industry, agriculture, and trade — directly influencing production and employment.

Together, they ensure that the financial resources are efficiently allocated across the economy.

V. CHALLENGES FACED BY BANKS

Despite their importance, both central and commercial banks face challenges such as inflationary pressures, exchange rate fluctuations, technological disruptions, and issues of non-performing loans.

Ensuring transparency, strengthening financial literacy, and maintaining regulatory discipline are essential for overcoming these challenges.

CONCLUSION

In conclusion, the central bank and commercial banks are the twin pillars of the financial system. While the central bank safeguards monetary stability, commercial banks serve as the lifeblood of financial intermediation. A strong and transparent coordination between them ensures economic resilience and promotes national prosperity.

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