Next Scientists
Journal of Management and Economics

TYPE Original Research
PAGE NO. 59-62
DOI 10.55640/jme-05-04-10

Mechanism for Optimizing Interbank Currency Exchange to Enhance Market Liquidity and Ensure Exchange Rate Stability

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OPEN ACCESS

SUBMITTED 28 February 2025
ACCEPTED 24 March 2025
PUBLISHED 28 April 2025
VOLUME Vol.05 Issue04 2025

Abstract: In modern monetary policy, optimizing the mechanism of interbank currency trading plays a vital role in enhancing the liquidity of the foreign exchange market and reducing devaluation pressures. Transparent exchange rate formation and reduced transaction costs are key factors that can lead to a more stable and efficient foreign currency system.

Keywords: Foreign exchange market, exchange rate stability, interbank trading, currency liquidity, monetary policy, devaluation pressure, market mechanisms, transaction costs, transparency, central bank interventions, managed float regime, Uzbekistan economy, macroeconomic stability, exchange rate formation.

Introduction: In modern monetary policy, optimizing the mechanism of interbank currency trading plays a vital role in enhancing the liquidity of the foreign exchange market and reducing devaluation pressures. Transparent exchange rate formation and reduced transaction costs are key factors that can lead to a more stable and efficient foreign currency system.

METHOD

The interbank foreign exchange market is where commercial banks exchange foreign currencies based on demand and supply. High liquidity in this market leads to more stable exchange rates and reduced speculative volatility. The following table presents the relationship between transaction volume and exchange rate volatility in a sample of emerging markets.

The interbank foreign exchange market is a vital

component of the broader currency market where financial institutions engage in currency trades. Optimization in this context refers to improving the efficiency of transactions through better pricing mechanisms, automated trading systems, and regulatory oversight. The key theoretical aspects include market microstructure theory, liquidity provision, and exchange rate pass-through effects.

Table 1: Transaction Volume and Exchange Rate Volatility (Sample Data)

Country	Avg Daily FX Volume (USD million)	Exchange Rate Volatility (%)
Uzbekistan	120	6.2
Kazakhstan	210	5.1
Poland	520	3.4
Vietnam	300	4.8

Many emerging economies face challenges such as insufficient market depth, speculative volatility, and high spreads between bid and ask prices. Lack of transparency and poor communication between market participants can lead to inefficiencies and discourage foreign investment.

To demonstrate the role of interbank exchange mechanisms, we consider the following simulated data reflecting exchange rate volatility and liquidity levels in countries with and without optimized interbank platforms.

The proposed model includes a centralized trading platform integrating real-time transaction data, automated clearing systems, and adaptive regulatory interventions. This model improves market depth, reduces spreads, and enables better policy coordination. In mathematical terms, the model can be represented as:

Liquidity Index (LI) = (Interbank Volume / Total FX Volume) × (1 - Bid-Ask Spread)

This equation helps measure how efficiently liquidity is allocated in the currency market.

To ensure sustainable exchange rate policies, central banks should prioritize building robust interbank infrastructures. This includes enhancing digital trading capabilities, enforcing transparency rules, and providing macroprudential oversight. In countries like Uzbekistan transitioning from fixed to more flexible regimes, such mechanisms are essential to manage expectations and prevent speculative attacks.

To reduce transaction costs and improve transparency, it is proposed to centralize all interbank foreign exchange transactions through a digital auction platform. This platform would match supply and demand in real-time, based on transparent pricing algorithms. The introduction of such a mechanism can bring the following benefits:

reduction in transaction time and cost;

increased participation by commercial banks;

enhanced transparency and confidence in exchange rate formation.

Table 2: Projected Effects of Implementing Optimized Interbank FX Platform

Indicator	Before Implementation	After Implementation
Average Bid-Ask Spread (%)	1.25	0.60
FX Transaction Time (minutes)	35	10
Exchange Rate Deviation from Market Value (%)	3.8	1.2

The effective optimization of interbank currency trading mechanisms has significant potential to stabilize the foreign exchange market and foster macroeconomic balance. Implementing transparent, low-cost, and liquid auction-based systems not only improves exchange rate reliability but also enhances monetary policy transmission. Given the positive projected impacts, such reforms are a strategic

necessity for developing and transitional economies, including Uzbekistan.

In recent years, the development of interbank foreign exchange trading mechanisms has played a vital role in enhancing market efficiency and monetary policy transmission. Optimizing such systems directly influences the liquidity level of the foreign exchange market and contributes to reducing speculative pressures on the national currency.

One critical factor in this optimization process is the enhancement of transactional transparency. By increasing access to real-time exchange rate data and streamlining trading protocols, central banks can foster a more predictable and investor-friendly environment. The resulting decline in transaction costs encourages more active participation from financial institutions, thus deepening market liquidity.

Empirical studies suggest that countries with advanced interbank foreign exchange infrastructures tend to experience lower volatility and improved macroeconomic stability. For example, the implementation of electronic trading platforms in emerging markets has correlated with narrower bid-ask spreads and higher daily trading volumes. This evidences the practical advantages of integrating digital solutions into traditional trading systems.

Moreover, by setting precise guidelines for currency interventions and facilitating standardized clearing procedures, central banks can reduce market uncertainty. These reforms are particularly important in economies transitioning from administratively controlled to market-driven exchange rate regimes. A measured approach to liberalization—paired with robust supervision—can yield lasting stability and investor confidence.

Ultimately, the harmonization of monetary policy tools with foreign exchange market operations ensures a feedback loop that reinforces macroeconomic resilience. When banks are empowered to trade with minimal friction under a regulated framework, the resulting improvements in efficiency are felt throughout the economy, influencing inflation, interest rates, and cross-border capital flows.

In order to further enrich the understanding of interbank foreign exchange market optimization, it is essential to delve deeper into the economic rationale behind liquidity enhancement and devaluation pressure reduction. Interbank foreign exchange trading, when optimized effectively, serves as a powerful channel for minimizing transaction costs and increasing price transparency. This, in turn, leads to improved market efficiency and a more stable macroeconomic environment.

Firstly, enhanced liquidity reduces the bid-ask spread, encouraging more active participation from market players including commercial banks, investment institutions, and foreign investors. The increased participation leads to a self-reinforcing cycle of stability and transparency. This is particularly important for emerging economies where the exchange rate plays a significant role in trade competitiveness and inflation targeting.

Secondly, the optimization mechanism must include advanced tools such as electronic trading platforms, real-time settlement systems, and standardized regulatory frameworks to ensure trust and security in the marketplace. These instruments help improve the speed and reliability of transactions, thus further reducing operational risks.

Thirdly, interbank market depth and liquidity serve as key indicators of currency stability. The central bank's intervention policy should be aimed at smoothing excessive volatility rather than pegging the rate, which could lead to long-term imbalances. For instance, introducing a floating exchange rate within a managed band allows for better absorption of external shocks while maintaining investor confidence.

CONCLUSION

In conclusion, the foreign exchange market plays a critical role in monetary policy transmission. A liquid interbank market ensures that interest rate adjustments by the central bank are effectively transmitted through exchange rate expectations and capital flows. It also allows for better hedging opportunities for firms engaged in international trade, hence supporting broader economic development.

A comprehensive reform of the interbank FX trading framework should also address the asymmetries in information access and market power among participants. Implementing centralized trading platforms, encouraging transparency in deal reporting, and establishing a robust supervisory system are crucial elements of such a reform.

To conclude, optimizing interbank foreign exchange trading mechanisms is not merely a technical reform; it is a strategic imperative that influences financial stability, investor sentiment, and the overall macroeconomic performance. The interplay between transparent price discovery, market liquidity, and effective regulation forms the cornerstone of a resilient foreign exchange market architecture.

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