



## Financial markets and their impacts on economic growth

R Dinesh

BBA.BL Hono Student, Saveetha School of Law, Poonamallee, Tamil Nadu, India

### Abstract

This paper deals with the analysis whether financial markets have an impact on economic growths. Firstly, financial market is a broad term which describes a market place where people trade their financial securities including bonds, currencies and equities, and precious metals and agricultural products. It also includes commodities, and other fungible items of value at very low transaction cost and also at prices that affect the supply and demand. The status of the financial market depends upon the transaction of trade on the basis of which financial market can be classified as small depending upon low activity and big which trades in billions, trillions etc. for example small financial market can be of an individual person with low capital, securities or investment whereas the example for large market is foreign exchange market. In the financial system funds flow from those who have surplus funds to those who have a shortage of funds, either by direct, market-based financing or by indirect, bank-based finance. The former British Prime Minister William Gladstone expressed the importance of finance for the economy in 1858 as follows: "*Finance is, as it were, the stomach of the country, from which all the other organs take their tone.*" The financial system comprises all financial markets, instruments and institutions. The financial system is also particularly important in reallocating capital and thus providing the basis for the continuous restructuring of the economy that is needed to support growth. In countries with a highly developed financial system, we observe that a greater share of investment is allocated to relatively fast growing sectors.

**Keywords:** financial marketing, economic growth, transaction, commodities, funds

### Introduction

Financial markets help to efficiently direct the flow of savings and investment in the economy in ways that facilitate the accumulation of capital and the production of goods and services. The combination of well-developed financial markets and institutions, as well as a diverse array of financial products and instruments, suits the needs of borrowers and lenders and therefore the overall economy.

### What are financial markets and institutions?

Financial markets (including people who exchange shares or bonds), gadgets (from bank CDs to futures and derivatives), and institutions (from banks to coverage companies to mutual funds and pension funds) offer opportunities for buyers to specialize in specific markets or services, diversify risks, or both <sup>[1]</sup>. As noted with the aid of Demirgüç-Kunt and Levine, together financial markets and monetary establishments make a contribution to monetary increase; the relative blend of the two does not now seem like an essential aspect in growth. Big economic markets with masses of trading interest offer more liquidity for marketplace members than thinner markets with few available securities and participants and accordingly limited trading opportunities. The financial device is typically taken into consideration to be the quality developed inside the international. Each day transactions inside the economic markets—both the money (short term, a year or less) and capital (over a year) markets—are massive. Many economic belongings are liquid; some may additionally have secondary markets to facilitate the transfer

of current monetary property at a low price.

### Why are financial markets and institutions important?

Financial markets play an important function within the accumulation of capital and the manufacturing of products and offerings. The charge of credit and returns on investment offer alerts to manufacturers and purchasers known as financial market members. Those indicators assist direct budget (from savers, especially households and businesses) to the clients, corporations, governments, and buyers that would love to borrow cash by using connecting folks that value the finances most fairly (i.e., are willing to pay a better charge, or interest rate), to inclined creditors. In a comparable manner, the lifestyles of sturdy financial markets and institutions additionally enable the international go with the flow of finances between nations. Similarly, efficient financial markets and institutions generally tend to decrease seek and transactions expenses within the economy. by means of imparting a large array of monetary products, with various risk and pricing systems in addition to adulthood, a nicely-advanced monetary gadget offers merchandise to contributors that offer debtors and creditors with a close healthy for his or her wishes. People, businesses, and governments in need of funds can without difficulty find out which monetary establishments or which monetary markets may also provide funding and what the fee may be for the borrower. This lets in traders to evaluate the fee of financing to their predicted return on funding, for that reason making the funding choice that nice fits their desires. On this manner, economic markets

direct the allocation of credit score for the duration of the financial system—and facilitate the production of products and services.

### **What happens without well-developed financial markets?**

In many developing nations, restricted monetary markets, instruments, and financial institutions, in addition to poorly defined felony systems, may make it extra costly to raise capital and may lower the return on savings or investments [2]. constrained statistics or loss of economic transparency imply that statistics isn't as without difficulty to be had to market contributors and risks can be higher than in economies with more absolutely-advanced financial systems. in addition, it's miles greater tough to keep a varied portfolio in small markets with best a constrained choice of monetary assets or savings and investment products. in such skinny financial markets with little buying and selling hobby and few alternatives, it is able to be extra hard and steeply-priced to locate the right product, maturity, or risk profile to fulfill the wishes of debtors and creditors.

### **Types of Financial Markets** [3]

#### **• Capital Markets**

A capital market is one in which individuals and institutions trade financial securities. Organizations and institutions in the public and private sectors also often sell securities on the capital markets in order to raise funds. Thus, this type of market is composed of both the primary and secondary markets.

Any government or corporation requires capital (funds) to finance its operations and to engage in its own long-term investments. To do this, a company raises money through the sale of securities - stocks and bonds in the company's name. These are bought and sold in the capital markets.

#### **• Stock Markets**

Stock markets allow investors to buy and sell shares in publicly traded companies. They are one of the most vital areas of a market economy as they provide companies with access to capital and investors with a slice of ownership in the company and the potential of gains based on the company's future performance. This market can be split into two main sections: the primary market and the secondary market. The primary market is where new issues are first offered, with any subsequent trading going on in the secondary market.

#### **• Bond Markets**

A bond is a debt investment in which an investor loans money to an entity (corporate or governmental), which borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities. Bonds can be bought and sold by investors on credit markets around the world. This market is alternatively referred to as the debt, credit or fixed-income market. It is much larger in nominal terms than the world's stock markets. The main categories of bonds are corporate bonds, municipal bonds, and U.S. Treasury bonds, notes and bills, which are collectively referred to as simply "Treasuries."

#### **• Money Market**

The money market is a segment of the financial market in which financial instruments with high liquidity and very short maturities are traded. The money market is used by participants as a means for borrowing and lending in the short term, from several days to just under a year. Money market securities consist of negotiable certificates of deposit (CDs), banker's acceptances, U.S. Treasury bills, commercial paper, municipal notes, Eurodollars, federal funds and repurchase agreements (repos). Money market investments are also called cash investments because of their short maturities.

The money market is used by a wide array of participants, from a company raising money by selling commercial paper into the market to an investor purchasing CDs as a safe place to park money in the short term. The money market is typically seen as a safe place to put money due the highly liquid nature of the securities and short maturities. Because they are extremely conservative, money market securities offer significantly lower returns than most other securities. However, there are risks in the money market that any investor needs to be aware of, including the risk of default on securities such as commercial paper.

#### **• Cash or Spot Market**

Investing in the cash or "spot" market is highly sophisticated, with opportunities for both big losses and big gains. In the cash market, goods are sold for cash and are delivered immediately. By the same token, contracts bought and sold on the spot market are immediately effective. Prices are settled in cash "on the spot" at current market prices. This is notably different from other markets, in which trades are determined at forward prices.

The cash market is complex and delicate, and generally not suitable for inexperienced traders. The cash markets tend to be dominated by so-called institutional market players such as hedge funds, limited partnerships and corporate investors. The very nature of the products traded requires access to far-reaching, detailed information and a high level of macroeconomic analysis and trading skills.

#### **• Derivatives Markets**

The derivative is named so for a reason: its value is derived from its underlying asset or assets. A derivative is a contract, but in this case the contract price is determined by the market price of the core asset. If that sounds complicated, it's because it is. The derivatives market adds yet another layer of complexity and is therefore not ideal for inexperienced traders looking to speculate. However, it can be used quite effectively as part of a risk management program. Examples of common derivatives are forwards, futures, options, swaps and contracts-for-difference (CFDs). Not only are these instruments complex but so too are the strategies deployed by this market's participants. There are also many derivatives, structured products and collateralized obligations available, mainly in the over-the-counter (non-exchange) market that professional investors, institutions and hedge fund managers use to varying degrees but that play an insignificant role in private investing.

- **Forex and The interbank market**

The interbank market is the financial system and trading of currencies among banks and financial institutions, excluding retail investors and smaller trading parties. While some interbank trading is performed by banks on behalf of large customers, most interbank trading takes place from the banks' own accounts. The forex market is where currencies are traded. The forex market is the largest, most liquid market in the world with an average traded value that exceeds \$1.9 trillion per day and includes all of the currencies in the world. The forex is the largest market in the world in terms of the total cash value traded, and any person, firm or country may participate in this market. There is no central marketplace for currency exchange; trade is conducted over the counter. The forex market is open 24 hours a day, five days a week and currencies are traded worldwide among the major financial centers of London, New York, Tokyo, Zürich, Frankfurt, Hong Kong, Singapore, Paris and Sydney.

Until recently, forex trading in the currency market had largely been the domain of large financial institutions, corporations, central banks, hedge funds and extremely wealthy individuals. The emergence of the internet has changed all of this, and now it is possible for average investors to buy and sell currencies easily with the click of a mouse through online brokerage accounts.

### **Economic Growth**

Considering financial development has developed over the past half of century, partly in reaction to perceptions of poverty and theorizing approximately its causes (and inferring from those the presumed wanted policy movements) and partly through the revel in of development in countries each a success and unsuccessful. All through those years, there were a number of "fads", or really single causation theories, as to "the" causative issue (or, perhaps, factors), in large part in response to perceptions that improvement was less rapid than it ought to have been.

All through the past decade, a great deal of the "fad" and the emphasis has been placed on knowledge the role of the financial sector, in component because earlier instructions have been discovered, and in part because of the monetary crises of the 1990s. Information of the position of the economic zone has expanded markedly, but studies and insights hold to mount. as that has befallen, a few have turned to "governance issues" as "the key" to improvement, but instructions about the importance, and key function, of the economic region in improvement have honestly been discovered<sup>[4]</sup>.

There has been no time at which economists and policy makers denied the role of the economic region. However, I suppose it's far truthful to mention that its significance become systematically underestimated prior to the enjoyment of the 1990s. Honestly, I actually was guilty of nodding settlement with folks who argued for its importance, even as turning my attention almost right away lower back to troubles of exchange, agriculture, public management, and so forth.

I begin with a brief evaluate of the earlier foci of evaluation, noting how they interacted with information of development on the time. in the very last part of my talk, I'm able to then relate the earlier understandings and the function of financial

variables in development. In among, I will come to financial markets, and the experience of the Nineteen Nineties, illustrating with a few facts from the Korean revel in. I'm able to give up with an evaluation of the coverage implications of the progressed expertise of the function of the monetary gadget and its additives.

### **Analyzing Poverty and Growth**

Previous to the second international struggle, evaluation of economic growth changed into nearly the exclusive domain of economic historians, and attention changed into largely on how the west grew rich - particularly, the commercial revolution. Despite the fact that everyone knew that residents of some nations had an awful lot higher dwelling standards than those in others, that appeared to be taken as a "state of nature", not a difficulty to be addressed or understood. And, indeed, there seemed to be a few justifications for that bipolar view. Few international locations had been inside the "middle". Ignoring the centrally planned economies, which have been typically visible as sui generis, the sector changed into visible as such as the "developed" and the "underdeveloped" (in the endless advanced, then developing) international locations. ignoring a few mineral rich locations, generalizations may be made that the majority developing nations had low in line with capita incomes, low existence expectancies, low tiers of literacy and academic attainment, terrible health statistics, little capital stock and occasional financial savings fees, and an economic structure closely skewed towards subsistence agriculture with exports consisting overwhelmingly of primary commodities and imports of manufactured items.

From those stylized, however normally legitimate, generalizations, came the initial "fad" in improvement: poverty and occasional productivity had been rife due to low levels of capital stock consistent with employee; low levels of capital stock per employee resulted from the inability of bad humans to store; and hence there has been a "vicious" circle. the coverage implications had been seen, by means of most, to be that government had to take a leading position in improvement, and that improvement ought to be spurred by task extended investments in industry (which turned into by way of speculation of better productivity), doing so by using growing investment in each the general public and the personal sectors. The authorities of India's making plans fee, for example, concluded that, if India could attain a financial savings rate of 25 consistent with cent of GDP within a quarter century, growth might accelerate sufficiently to bring about monetary improvement.

Through the early Sixties, there came recognition that capital accumulation turned into insufficient: attention had to be paid to augmenting "human capital", and the focal point shifted to training and different elements (inclusive of fitness and nutrients) that would boom individuals' productiveness in all regions along with enterprise however also agriculture. With the first-rate exception of a few East Asians, but, development coverage remained closely oriented to growing enterprise (in the public and private sectors) and elevating fees of funding. Furthermore, efforts to inspire business development targeted on safety of domestic industry from imports via import

prohibitions or restrictive import licensing and excessive tariff tiers.

One end result, which came about in most developing - as they have been then known as - countries become that continual "foreign exchange shortages" resulted in gross inefficiencies in a selection of ways, and simply had been a disincentive for the development of any new export activities. It got here increasingly more to be appreciated with the aid of the 1970s and 1980s that an overestimated alternate rate itself become one disincentive for improvement of exports, but so too had been high tariff levels and prohibitions or restrictions on imports. A few east Asian international locations have been already following an improvement approach that focused on shifting away from "internal oriented" boom closer to "outer orientated" method. They skilled rapid boom of real output and exports, and were a success to a point that had earlier now not seemed viable. For this reason, by the overdue Eighties, focus changed into on the reduction of change limitations and an open economy as a vital part of the prescription for fast economic growth, alongside training and other investments in people, and excessive financial savings charges. At the identical time, and both from direct experience and because of the collapse of important planning, skepticism grew concerning the efficacy of nation-owned organizations carrying out production sports. Reputation of the role of competition accelerated, even though it was by no means an imperative fad.

With all of this, the revel in of the East Asian "tigers" - Hong Kong, Singapore, south Korea, and Taiwan - was extra special. By means of 1990, South Korea had found out a fee of actual economic boom that greater than doubled consistent with capita earnings every decade. The US and others experiencing similar growth prices, become converted. It no longer made sense to regard all non-business international locations as homogeneous - a diffusion of distinctions (rising markets, center-profits nations, etc.) came to be hired. However all those in the coverage and educational groups concerned with improvement diagnosed the extraordinary success of the "tigers" over a totally long time period. At the same time as they debated the relative contributions of different factors to those excessive increase fees, nobody should doubt the sustained achievement of those economies over the long time.

Via the Eighties, different Asian nations had all started to follow the equal sample. China, Thailand, Malaysia, and Indonesia all skilled real fees of boom that have been very high contrasted with their in advance enjoy and with that of other nations in other regions. For that reason, despite the fact that Mexico experienced a crisis in 1994 (and Russia and Brazil crises in 1998 and 1999), the Asian "miracle" countries were broadly regarded as immune from increase slowdowns, a whole lot less crises of the Mexican variety.

It needs to be noted that there had in advance been any variety of "foreign exchange" or financial crises. In maximum times, those had took place when monetary policies had sustained unrealistic (overestimated) exchange quotes via the use of change controls and regulations on capital flows, if no longer cutting-edge account transactions. Those crises were typically brought on by way of problems in home banking systems, in

the case of monetary crises (together with Sweden in 1992) or via a country's inability either to borrow similarly to finance its cutting-edge account deficit (which includes in Turkey in 1980) or to limit its imports similarly.

It became the "Asian crises" of 1997 that stunned the arena: apparently unstoppable successful international locations had reputedly foundered. There has been a continuing outflow of foreign exchange, and governments confronted the possibility that they might be unable to honor their overseas responsibilities. Korea, for example, had skilled capital inflows of as much as 10 percent of GDP at some point of the Sixties and 1970s, but had prevented the "debt crises" of different international locations inside the 1980s both because of the rapid growth of exports and due to the fact the debt-GDP ratio and debt-export ratio without a doubt fell throughout that equal period. As a symptom of their success, the Asian economies have been regarded as rather creditworthy, so that the shocks of 1997 were the entire extra. The proximate "reasons" of the crises have been capital outflows, and the crises were first of all blamed on "speculators", "warm cash", "contagion", and so on. But similarly evaluation confirmed that, even though capital outflows were the "forcing" phenomenon that caused crisis, there were underlying elements that had come into play. While those elements differed from case to case, there were extensive commonalities.

It is not the cause here to check the panoply of classes found out, or to analyze the policy responses to the crises (about which there has been huge controversy). Suffice it to mention that there is full-size agreement that a set trade charge regime in most cases removes a main surprise absorber and may, in the absence of suitable supporting policies, itself bring about predominant difficulties. There are long ways fewer constant exchange rate regimes inside the international than there have been in the mid-1990s. There may be additionally a significantly heightened cognizance of the need to examine debt sustainability, as well as current flows. And there is extended recognition of the importance of the need for consistency among home financial and fiscal coverage and the exchange rate regime. For a lot of these motives, there's actually decreased threat of crisis. But, in addition, as the revel in of the past due Nineteen Nineties has been further analyzed, popularity of the necessity of financial sector improvement inside the path of economic increase has extended.

### **The role of the financial sector**

We have long recognized about the significance of the monetary region in assisting an green allocation of resources and economic increase. However it has perhaps now not been so properly diagnosed that as economies broaden, the monetary gadget becomes increasingly essential both as a facilitator of economic increase (if it's far performing its features and growing with the rest of the economy) or as an inhibitor (if it remains underdeveloped)<sup>[5]</sup>. Whilst economic activity is at its maximum fundamental, performed inside a confined geographical location with plenty subsistence hobby, a surprisingly small fraction of overall financial output is traded, and therefore the need for cash and finance is restrained. Reliance on circle of relatives finance can function a sufficient source of finances for small and even large

companies. Moreover, in the ones situations, it could even be that credit rationing can do a fairly reasonable job of allocating credit: high real rates of return opportunities (including in mining or the manufacture of those few gadgets fed on by way of bad families along with candles, suits, radios, and the like) may be particularly self-obtrusive in economies with very simple structures. but because the variety of economic sports increases, now not handiest in manufacturing, however additionally in agriculture (as rising earning lead consumers to shift more of their intake away from basic food grains) and offerings, ease of reputation of "high-quality initiatives" turns into greater hard. Reliance on circle of relatives finance soon starts off evolved to inhibit growth. Greater financial intermediation is needed if incremental sources are to be allotted efficaciously, due to constraints in any other case imposed at the increase of greater worthwhile sports, specifically when small. Banking involves play a more position in increasing resources for high-return activities and decreasing the quantity wasted in decrease return ones. However, with healthful increase, opposition is crucial, and each danger and go back considerations are vital. Therefore, the financial device must develop in its ability to allocate assets.

Because the economic system grows, and grows more complex, the economic sector desires to keep pace. Banks want to grow and emerge as more state-of-the-art of their ability to evaluate possibilities for dangers and returns; and, in parallel, their desires to be the development of different economic sources of funding capital. Sustained and fast growth needs to be underpinned via a broadening and deepening of the monetary system, capable of serving the desires of all elements of the economic system. The ones economies which have sustained fast boom over the long term have skilled giant structural change, as they have shifted from being predominantly rural and agricultural to a extra urban, production-and-service-based shape.

This changed into genuinely the history of the industrialized international locations. As they grew in the eighteenth, 19th and twentieth centuries, their financial systems grew intensive and breadth. Inside the 19th century, London achieved its status as the world's leading monetary middle, because the monetary zone had advanced swiftly so one can serve the needs of British industry and British exporters. Because it grew with the intention to assist Britain's financial boom, it also became a main contributor to that increase - and, for that matter, to boom in different components of the arena because it exported capital and economic competencies.

Within the twentieth century, the big apple performed a similar role with regards to the yankee economic system. As New York developed as a monetary middle to serve the needs of the dynamic and rapidly growing American economy, so it evolved the competencies and services that might themselves be exported.

And this procedure has persevered. The growth in hedge funds in latest years is an instance of this continuing development in financial markets. And as the monetary sector in industrial countries has become more complicated, it has posed clean challenges for those charged with making sure that the financial sector is sound and properly-functioning.

Even 20 or 30 years in the past, no person could have

quarreled with anything I've said to this point. Ronald McKinnon wrote of "monetary repression" and its fees in terms of foregone boom in the Nineteen Seventies, and maximum improvement economists blanketed "credit score rationing" a number of the regulations and practices in growing international locations that hampered their boom. However the economic crises of the 1990s added domestic to each person the significance of the financial machine and its easy functioning. What we had perhaps not completely liked turned into the extent to which the health and effectiveness of the financial zone turned into sure up with the performance of the economic system as a whole. I shall illustrate the argument with an overview of the methods wherein the failure of the economic device to expand *Pari Passu* with the rest of the financial system contributed to the Korean crisis of 1997-1998.

### Conclusion

Financial markets create an open and regulated device for businesses to get large amounts of capital. This is finished via the stock and bond markets. Markets additionally permit these agencies to offset risk. They try this with commodities, foreign exchange futures contracts and different derivatives. Since the markets are public, they offer an open and obvious way to set charges on the whole thing traded. They reflect all available information approximately the entirety traded. This reduces the cost of getting records, because it's already integrated into the amount. The sheer length of the monetary markets offers liquidity. In other phrases, sellers can unload property whenever they want to elevate coins. The dimensions additionally reduces the fee of doing commercial enterprise, on account that corporations don't must go a long way to discover a consumer, or a person inclined to sell.

### Reference

1. [www.frbsf.org](http://www.frbsf.org) accessed on 10<sup>th</sup> September, 2017.
2. [www.frbsf.org](http://www.frbsf.org) accessed on 10<sup>th</sup> September, 2017.
3. [www.thebalance.com](http://www.thebalance.com) accessed on 10<sup>th</sup> September, 2017.
4. [www.imf.org](http://www.imf.org) accessed on 10<sup>th</sup> September, 2017.
5. [www.societegenerale.com](http://www.societegenerale.com) accessed on 10<sup>th</sup> September, 2017.