

Role of Financial Markets

Financial markets are places or systems where buyers and sellers trade **financial assets**, such as bonds, equities, currencies and derivatives.

They perform several important functions within an economy.

Facilitate Saving

Financial institutions provide a safe place for households and firms to save money, often in return for interest.

Savings can then be lent to others → **one person's saving becomes another person's borrowing** → funds can be used for consumption and investment.

Lend to Businesses and Individuals

Financial institutions act as **intermediaries between savers and borrowers**.

Savings are deposited → banks lend these funds to households and firms → consumption and investment increase → AD and economic growth may increase.

For example, households can use mortgages to purchase homes, while firms can borrow to finance expansion and investment.

Facilitate the Exchange of Goods and Services

Financial markets allow money to move quickly and securely between buyers and sellers.

Payment methods include:

- Debit and credit cards
- Bank transfers
- Mobile payments
- Online payment systems

This makes the exchange of goods and services easier and more efficient.

Provide Forward Markets in Currencies and Commodities

Forward markets allow firms and investors to **agree today on a price for a currency or commodity that will be exchanged in the future**.

Firms can hedge against changes in exchange rates or commodity prices → uncertainty and risk fall → future costs become easier to predict.

Forward markets can also be used for **speculation**, where investors attempt to profit from future price movements.

Written by udoecon.com

Provide a Market for Equities

Equities are shares in publicly listed companies. Financial markets such as stock exchanges bring together buyers and sellers of these shares.

Firms sell shares → finance is raised for investment → productive capacity may increase → economic growth may increase.

Investors may also benefit from **dividends and capital gains**.