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THE IMPORTANCE OF THE FINANCIAL MARKET IN THE ECONOMY

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Abstract:
This study analyzes the role and importance of the financial market in the economy. The financial market plays an important role in the concentration of capital, efficient allocation of resources, stimulation of investments and ensuring economic growth. The study examines the main functions, structure and impact of the financial market on economic processes. The efficiency, transparency and stability of the financial market are assessed as important factors of economic development. The study also analyzes policies for the regulation, control and development of the financial market. In conclusion, it is emphasized that the financial market is an integral part of the economy and its stable functioning is necessary for ensuring economic growth and prosperity.

Keywords: Financial market, capital, investment, resource allocation, economic growth, efficiency, transparency, stability, regulation.

Introduction

The financial market is an important and integral part of the economy, which plays a major role in the allocation of economic resources, attraction of capital and direction of investments. Financial markets not only provide the necessary financial instruments for enterprises and countries, but also create opportunities for diversification and risk management for individual investors. This article examines the importance of financial markets in the economy, their functions and mechanisms, as well as the impact of an efficient financial market on economic growth. The strength and efficiency of financial markets are important factors in achieving economic stability, and research and practice in this area are expected to open up new opportunities and aspects for us.

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Main part:

Improving the efficiency of capital allocation:

• **Markowitz Portfolio Theory:** Investors try to optimize their portfolios to balance risk and return. The expected return of a portfolio is expressed as:

$E(Rp) = \sum wi * E(Ri)$

Where:

E(Rp) - expected return of the portfolio

wi - share of asset i in the portfolio

E(Ri) - expected return of asset i

The risk (standard deviation) of the portfolio is expressed as:

$\sigma p = \sqrt{\sum\sum wi * wj * Cov(Ri, Rj)}$

Where:

σp - standard deviation of the portfolio

Cov(Ri, Rj) - covariance between the returns of assets i and j

• **Capital Asset Pricing Model (CAPM): The expected return of an asset is related to its market risk:** $E(Ri) = Rf + \beta i * (E(Rm) - Rf)$

Where:

E(Ri) - expected return of asset i

Rf - safe level

βi - beta coefficient of asset i (sensitivity to market risk)

E(Rm) - expected return of the market portfolio

• **Efficient Market Hypothesis (EMH):** Prices in financial markets reflect all available information, which eliminates the possibility of overvaluing or undervaluing assets.

2. Risk diversification and management:

• **Insurance market:** Insurance companies pool risks across a large number of policyholders, thereby reducing individual risks.

• **Derivatives:** Derivatives such as futures, options, and swaps can be used to manage risks related to exchange rates, interest rates, and commodity prices.

• **Value at Risk (VaR):** A method of estimating the maximum loss that can be expected over a given period of time with a given level of confidence.

• **Stress testing:** A method of assessing how financial institutions will perform under extreme conditions.

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3. Improving corporate governance:

• **Shareholder control:** Financial markets allow shareholders to control a company's operations and encourage management to be more efficient.

• **Ownership distribution:** The ownership of a company can change through the sale and purchase of shares, which affects the company's performance.

• **Incentive mechanisms:** Shares and options encourage managers to act in the best interests of the company.

• **Credit rating agencies:** Credit rating agencies assess the financial stability of companies and serve as an important source of information for investors.

4. Stimulating economic growth:

• **Financing innovation:** Financial markets provide an opportunity to finance innovative companies through venture capital and IPOs.

• **Mobilizing funds:** Financial markets pool savings from the population and channel them to finance investment projects.

• **Improving microeconomic efficiency:** Financial markets improve microeconomic efficiency by allocating resources more efficiently.

• **Supporting macroeconomic stability:** Financial markets play an important role in implementing monetary policy and smoothing economic fluctuations.

5. Global Integration and International Capital Movements:

• **International Investment:** Financial markets facilitate cross-border investment, which contributes to a more efficient allocation of capital and economic growth.

• **Exchange Rate Risk Management:** Financial markets allow exporters and importers to minimize exchange rate risk.

• **Providing Global Liquidity:** Financial markets support international trade and investment by providing global liquidity.

6. Mobilization and concentration of capital: The financial market allows the accumulation of free cash of the population and enterprises and their allocation to investment projects. This contributes to the efficient allocation of capital and economic growth. Population savings - surplus income of the population is invested in the financial market, becoming a source of funds for the development of enterprises. Profits of enterprises - enterprises have the opportunity to increase

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capital and accelerate development by investing part of their profits in the financial market.

7. Efficient allocation of resources: The financial market plays an important role in the allocation of resources by directing capital to projects that use it most efficiently. This ensures high profitability of investments and contributes to economic growth. Price mechanism - In the financial market, asset prices are formed based on supply and demand. These prices give investors a signal about where to direct resources. Risk assessment - The financial market allows you to assess the risks of various investment projects and allocate appropriate funds to them.

8. Investment promotion: The financial market enables enterprises to raise capital and finance investments. This supports innovation, creates new jobs, and ensures the modernization of the economy. Issuance of securities - Enterprises can raise capital from the financial market by issuing shares and bonds. Venture capital - The financial market provides venture capital to finance startups and develop new technologies.

9. Ensuring economic growth: The financial market plays an important role in ensuring economic growth through the efficient allocation of capital, encouraging investment, and supporting innovation. Long-term investment - The financial market provides the opportunity to finance long-term investments and develop infrastructure. Innovation and technological progress - The financial market provides capital for the creation and introduction of new technologies, which increases the efficiency of the economy.

10. Risk Management: The financial market offers a variety of risk management instruments. Instruments such as hedging, diversification, and insurance allow investors to reduce risks and protect capital.
Types of financial markets: Money market - A market where transactions related to short-term debts and investments are carried out. Capital market - A market where transactions related to long-term debts and investments (stocks, bonds) are carried out. Foreign exchange market - A market where transactions related to the sale and

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purchase of different currencies are carried out. Derivatives market - A market where transactions related to derivative instruments such as forwards, futures, options, and swaps are carried out.

Summary

This article provides an in-depth analysis of the important role of financial markets in the economy, in particular, in improving the efficiency of capital allocation, risk diversification and management, and corporate governance.

Theories such as Markovitz Portfolio Theory, Capital Asset Pricing Model (CAPM), and Efficient Market Hypothesis (EMH) are important in improving the efficiency of capital allocation. These theories help investors optimize the balance between risk and return, value assets, and improve market efficiency.

The insurance market and derivatives play an important role in diversifying and managing risks. Insurance companies reduce individual risks by assuming risks, while derivatives provide the opportunity to manage risks associated with exchange rates, interest rates, and commodity prices. Methods such as Value at Risk (VaR) and Stress Testing help assess how financial institutions will perform under extreme conditions.

In improving corporate governance, the financial market provides shareholders with the opportunity to control the company's activities, distribute ownership, and encourage management to be more effective through the use of incentive mechanisms. Ratings by credit rating agencies assess the financial stability of companies and serve as an important source of information for investors.

This study contributes to a deeper understanding of the complex mechanisms of the financial market and its impact on the economy. The effective functioning of the financial market is essential for ensuring economic growth, stability, and prosperity.

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