

Role of Financial Markets in a Global Economy and the Concept of Uncertainty

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Abstract

Despite the fact that the 'Great Recession' may have ended, a common unusual process has soon followed across most of the highly developed economies across the globe. This is the process of restoring balance sheets in both the private as well as the public institutions. The manner in which this kind of deleveraging will develop or the duration it will last is still not very clear. Due to this form of deleveraging, the global recovery has been held back in addition to the fact that most of the individual economies across the globe are suffering heavily as a result of this (Valdez, 2000). When it comes to the euro region, there is much stagnation as the area struggles to come in terms with the primary crisis of balance-of-payment (Rengasamy, 2012). On the other hand, the United States has the issue of fiscal cliff to handle and this has had a great impact on its general economy (Suderman, 2013). China which has also experienced immense growth in the past has been forced to come in terms with the reduction in demand for its key products that it relies on as export. Finally, other emerging markets across the globe are also fighting so as to ensure a continuous growth of their economies despite the fact that there has been generally a decrease in demand as far as their exports are concerned (Wolf, 2009). This great uncertainty among different economies across the globe has created what is now being referred to as 'global economy of uncertainty'. It is important to note that in this global economy of uncertainty, financial markets have a great role to play as it shall be explained in this paper. The role played by these financial markets has been generally categorized as; intermediary functions, economic functions and the financial functions (John, 2007; Berg, 2010; Copeland, 2005; Fabozzi, 2002). These key categories of financial market functions clearly show the major role played by these markets as far as the global economy of uncertainty is concerned.

Keywords: Financial markets, Global economy, Economic uncertainty

Introduction

The global economy has been experiencing a synchronous slowdown. It is in this regard that there has been an establishment of a global economy of uncertainty (Wolf, 2009; John, 2007). This literally means that the level of uncertainty as regards to the global economic viewpoint has greatly increased. This issue has even been reinforced by anxieties on how the challenges associated with this will be addressed by policy-makers. The collective uncertainty has further complicated the recovery, generating retrenchment and other negative impacts on different

firms across the globe. Basically, whether businesses are in the US, Canada, UK, China or elsewhere across the globe, the impact of the dimming global prospects has been greatly felt (John, 2007).

For instance one the debt crisis associated with the euro-zone sovereign is certainly one of the main challenges. The Euro-zone crisis has been unfolding in a manner that may pose great, unpredictable, and impulsive impacts on entrepreneurs and their business in the coming future. As a result of the crisis, majority of companies have panicked and have started to rethink on strategies to survive in days to come. This is the uncertainty that is being referred to because, business all not sure of how they will survive or not in the future. The growth rate of companies and individual economies looks like it will be disappointing in the coming days based on the challenges that are closely associated with the global economy of uncertainty (Rengasamy, 2012; Elton & Brown, 2007).

In the United States on the other hand, the situation is not in any way different from the Euro-Zone. The country continues to have a relatively weak economic growth as well as increased rates of unemployment (Suderman, 2013). Despite the fact that there has been an agreement between the Republicans and the Democrats as regards to averting of the 'fiscal cliff' to try and salvage the situation, this is not a sufficient move since it only deals with the issues of tax (Suderman, 2013). The pertinent issues regarding the debt ceiling and how it can be raised as well as cutting on spending have experienced much disagreements and controversies. Unfortunately, this only contributes to the uncertainty of companies or business in the future. Basically, a veil of uncertainty has greatly associated with the global economy in the recent times due to the numerous economic issues that have been witnessed in the United States, the Euro-zone, China as well as other developing markets across the globe (Geisst, 2006). Despite the fact that it is not an easy task to pin point and analyze the increased uncertainty levels as far as the global economy is concerned, a solution must established in the earliest time possible so as to decrease the harmful economic impact that this has on people across the globe. In an effort to pin-point a possible solution to the uncertainty being experienced across the globe, this paper discusses the role played by financial markets in a global economy of uncertainty.

Role Played By The Financial Markets In The Global Economy Of Uncertainty

A financial market is a market whereby people, private and public companies can trade financial commodities and securities at prices dictated by the economic forces of demand and supply (Valdez, 2000). These financial commodities may comprise; agricultural goods, precious metals like gold and silver etc. Securities on the other hand are mainly bonds and stocks. According to economics, the term market basically means a meeting of buyers and sellers of a certain good or service and their aggregate business transactions in their own free will (Valdez, 2000). These markets are both general and specialized. General markets trade many commodities while specialized markets only trade one commodity (Berg, 2010).

The markets can further be classified into three other categories; free markets, command markets and mixed markets (Industrial System Research, 1996). Free markets are markets that are not regulated by the government. Prices of goods and services in these types of markets are reached upon through demand and supply forces. Command markets are purely controlled by the government. The government determines the prices of goods and services. The government is the main trader in this economy; it may produce, sell and distribute most of the important goods and services that the citizens need. Mixed markets are partly regulated by the government. Prices of commodities are mainly determined by the forces of

demand and supply. The government intervenes when the prices due to supply and demand in the economy are unfair to either the consumer or the producer. The government uses tools such as price floors and price ceilings. The government will set a price floor when the price of a good is too low for the producer to make profits. This set price is the lowest price the commodity will be sold for. A price ceiling is set when the price of a good is too high exerting unnecessary financial pressure on the consumer while the producers make an abnormal profit. This price is the highest price that producers are legally allowed to sell their goods at (Valdez, 2000; Industrial System Research, 1996).

Categorization of Financial Markets and The Role They Play In The Global Economy of Uncertainty

Within the business finance sector of the economy, the term financial market categorically refers to markets that are used to raise either long or short term finance. Long term finance is achieved in the capital markets while short term is achieved in the money markets.

Capital Markets

Capital markets are the first category of financial markets. These markets trade long term equity or debt backed securities. These markets channel wealth to institutions that make long term use such as companies and governments investments. To ensure order and enhance security of the wealth being traded, there are regulatory bodies that govern these markets. For example, the SEC (Securities and Exchange Commission) in the United States oversees the trading in its jurisdiction in this country. These markets are mostly on electronic trading systems that are computerized. They can only be accessed by bodies in the finance sector of corporations and governments but some can be accessed directly by the general public. The entities that host these markets are such as the government departments, stock exchanges and investment banks. These markets operate in such a way that money is provided for at least one year but mostly a much longer period than that. These markets are divided into four; primary markets, secondary markets, bond markets and stock markets (Pilbeam, 2010; Merton, 1990).

It is important to note that the capital market is a very significant aspect of any financial market and as a result, it plays a very fundamental role in the global economy of uncertainty. One key function that the capital market does is to mobilize savings among people and to ensure that those savings are directed to investments. As a result, the capital market ensures that financial resources are transferred from regions of surplus and/or wasteful areas to areas that have deficits despite being productive. This is a very key role since it ensures increased productivity among the various countries across the globe and as a result, the feeling of uncertainty may be greatly reduced (Industrial System Research, 1996; Valdez, 2000; Pilbeam, 2010).

Another fundamental role played by the capital markets is the promotion of economic growth. These markets ensure a smooth and accelerating economic growth process, besides being a reflection of the general economic conditions. A number of capital market institutions such as the non-bank financial intermediaries, distribute the resources in a rational manner as regards to the developmental requirements of a given country. Through proper resource allocation, trade and industry gets to grow positively and to expand both the private as well as in the public sectors. As a result, there is a balanced fiscal growth in different countries across the globe (Valdez, 2000; Pilbeam, 2010).

Through capital markets, the security prices can be stabilized and this is very important as regards to the global economy of uncertainty. Capital markets tend to control the stock and security values and hence ensure the reduction of any fluctuations as much as possible. Stabilization process is enabled by the provision of capital to borrowers at a reduced interest rate hence a reduction of the unproductive and speculative activities (Valdez, 2000; Industrial System Research, 1996).

Money markets

These markets provide short term financing for assets that are taking part in short term lending, borrowing, selling and buying. The period of time for maturity does not exceed one year. These markets use instruments such as: Eurodollar Deposits where it involves deposits that are made in American dollars in banks outside the US; Commercial Paper which are basically promissory notes issued by companies at a discount but redeemed at face value; Treasury Bills that are short term debts that mature in three to twelve months where the government is obliged to pay its creditors; Federal Fund or easily available funds that are either borrowed or lent to institutions usually in an overnight basis (Geisst, 2006; Pilbeam, 2010). Through their various functions, money markets play a major role regarding the global economy of uncertainty.

Functions of the Money Market

The money market as an integral part of financial markets performs key functions that are closely related to monetary matters. A major function is to facilitate the transfer of very large amounts of cash from one place to the other or from one economy to the other. Instead of large sums of money being transacted in forms of cash, it is safer to use the money markets instruments like the federal bills since it's safer and even more convenient to transfer big sums of money that way. It is also faster than transporting cash physically (Fama, 1976; Groz, 2009; Pilbeam, 2010).

Transfer of money from people with large sums of money to people without. This is a vital role that the money market plays so as to ensure that money circulation in the economy or across the global economy is high and also that the investors get a chance to make profits easily without being over involved. It also aids the individual governments in controlling money supply in the economy by offering treasury bills, the government collects the surplus amounts of money in circulation and this solves the problem of a high money supply in the economy (Copeland, 2005; Pilbeam, 2010).

The money market also allows the various governments across the globe to collect money. When the government needs money but does not have enough, it may use money market instruments to raise money as quickly as it can. For example, the government can offer treasury bills to the public for the citizens and corporate bodies to buy in return for a full refund plus interest. Treasury bills are a secure investment since the investors know exactly how much they will make by investing in them. Through this, governments are able to promote the growth of their economies and this is a fundamental aspect of reducing the kind of uncertainty being experienced as regards to the global economy.

Money market instruments are also used by individual governments as a monetary policy tool that is constantly being applied to control the amounts of money in the economy (Pilbeam, 2010; Valdez, 2000). They are used to reduce the inflation rates in the economy especially the demand pull inflation. They do this by reducing the amounts of money in circulation in the

economy (Fabozzi, 2002). It is also worth noting that money markets may also be utilized in the determination of interest rates in the economy but only in the short run.

Results and Discussion

Based on the above analysis of the key categories of financial markets, it is clear that their functions can be divided into three main groupings; intermediary functions, economic functions and the financial functions.

Intermediary functions

These are roles that are a go between the lenders and borrowers. They include:

Transfer of resources: Financial markets offer a platform for borrowers to meet lenders. Investors needing money to further their interest have a platform to meet their potential lenders. For example, a company needing money for investing may float bonds to the public. The money they collect from selling the company bonds will further their business interest. This also applies when the government sells bonds to raise its revenue. Companies also sell shares to the public, other companies and governments in a bid to raise investments money (Copeland, 2005).

Enhancing income: Lenders get to gain interest on their money depending on what they invest in. for example, when a lender buys bonds either corporate or government they get an interest once their bonds mature. This is a surplus to their income and contributes to the increase in the country's gross domestic product.

Productive usage: The financial markets ensure that people's extra income is well spent by cutting people's unnecessary spending. They also ensure an increase in investments in the country apart from encouraging the saving culture with an aim to invest. Financial markets ensure that the borrowed money is well spent in a productive way.

Capital formation: One of the main hurdles in starting a business or expanding one is the lack of capital or inadequate funds. The financial market is a platform for borrowers to get money from lenders. The companies get to sell bonds and shares and get to raise the capital needed to do business. The collective savings of individuals in the country get to channel their money to making more capital that leads to more businesses being formed and thus a higher standard of living plus an increased gross domestic product. (Fama, 1976).

Price determination: Financial markets offer grounds for analyzing and determining the net value of traded assets. Through the process of price discovery, they show a sign for fund allocation in accordance to the market forces of demand and supply.

Sale mechanism: The financial markets also offer grounds for selling financial assets. In such a case, the corporate financial assets are also evaluated for their net value by the financial markets. This aids in trading of stocks and knowing the net value of companies.

Information: Financial markets get to analyze massive amounts of data about companies that trade in these markets. This offers investors and the general public meaningful information on the trends in the business world. They also help the public in making decisions about what companies to invest in. This information is also used by the government in checking the economic progress of the country and also in knowing what sectors of the company need to be improved.

Financial Functions

The financial markets provide borrowers with money to invest with. Both the capital and money markets create capital for investors to further their business interest. Without

financial markets investors would have an extremely hard time finding the capital to invest in their business. Business growth would be very slow to grow and develop.

Providing lenders with an opportunity to make money and own assets without much effort involved in starting a business, ensuring growth in the business and seeing the business through its tough times. This is quite an advantage people can acquire a piece of the business by buying its shares. They can trade these shares any time they may need their money back. Dividends from the shares bought boost the income of individuals. Financial markets create liquidity in the market and ensure trading of funds.

Economic Functions

Saving mobilization: Financial markets encourage the culture of saving in the economy. More and more people choose to save with an aim to acquire shares and bonds. They are motivated by the profits they get in trading stocks and the interests generated in getting paid annual dividends plus the interest generated at the maturing of bonds. This saving culture will ensure that more money in the economy is spent in a progressive manner. This will in turn lead to more production and an increase in the country's gross domestic product. With these changes, the revenue collected in tax is highly increased. This will ensure that the standards of living in the country will improve. Hence, the economy will be positively affected by the collective decision of the people to invest in the money markets. It also makes it easier for the upcoming future entrepreneurs to invest ensuring sustainable growth and development of the economy. (Groz, 2009).

Investment: Financial markets encourage the entrepreneurs' spirit in the country. The more people invest their money rather than spending it, the more money is generated in the economy. With increased production and more investments in the economy, the economy grows in a phenomenal manner since continued investment is the back bone of the economy.

National growth: Financial markets foster growth of the economy by encouraging saving and investments. The two ensure development of social amenities and infrastructure such as schools, hospitals, roads among others. This paves the way for more growth apart from the fact that they are indicators of social and economic development.

Entrepreneurship growth: The financial markets have provoked young minds to come up with business ideas to invest in. This ensures perpetual starting of businesses across the country and leads to growth of the economy.

Industrial development: Financial markets ensure that industries in the economy get funds for investments. This leads to the growth and continuous expansion of the industries because of the ease of availability of capital from the public.

Technological development: With increased entrepreneurship, investments, savings and industrial growth, there is need for technological enhancements to keep up with these changes. Technological firms are therefore motivated by the need for more capable technology in the market to produce better, new and more tasks handling technology. This will lead to increased technological development and also, more investors would want to invest in this sector of the economy. New technology makes working more efficient, fast, and more productive and also ensures quality products and therefore boosts the economy in a big way.

Conclusion

As highlighted in this paper, it is clear that there has been a synchronous slowdown as regards to the global economy, hence the establishment of a global economy of uncertainty. For

instance, in the euro region, much stagnation has been experienced based on the crisis that has been greatly associated with the balance-of-payment. Similarly, the fiscal cliff in the United States is the other issue that has greatly affected the economy of the country. China and other emerging economies have also been negatively affected by the turn of events despite their immense and unaltered growth in the past. With the global economy of uncertainty, most of these economies have been forced to come in terms with the reduction in demand for their major exports, hence affecting their economies to a great extent. In addition to highlighting the issue of global economy of uncertainty, this paper has also discussed in detail the role that financial markets can or actually do play in regard to this issue. The role played by these financial markets can be classified into three major categories, namely; intermediary functions, economic functions and the financial functions.

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