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## THE POWER OF INTEREST AND PROFITABILITY RATES IN FINANCIAL MARKET DEVELOPMENT

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**Abstract:** This comprehensive article explores the pivotal role of interest and profitability rates in shaping financial market development. Focusing on the interplay between these rates and market behavior, the essay examines their influence on investment decisions, economic stability, and overall market performance. Drawing on insights from financial theory, empirical research, and real-world examples, the article elucidates the complex dynamics underlying the relationship between interest rates, profitability, and financial market growth. With a nuanced analysis of various financial intermediaries, debt markets, and channels for fund transfer, the article provides valuable insights into the mechanisms driving financial market development.

**Keywords:** Interest Rates, Profitability Rates, Financial Market, Development, Investment Decisions, Economic Stability, Financial Intermediaries, Debt Markets, Fund Transfer, Capital Markets.

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### Introduction

In the world of finance, interest and profitability rates play a pivotal role in shaping the financial market. These rates have the power to either stimulate growth or hinder progress. The impact of interest and profitability rates on financial market development is immense, as they serve as the foundation for investments, savings, and economic stability. This essay will delve into the crux of this relationship, highlighting the significant role that interest and profitability rates play in the development and growth of financial markets. By examining the various ways in which these rates influence market behavior and performance, this essay will shed light on the interplay between interest and profitability rates and their impact on financial market development.[1]

Interest rates can significantly impact the investment decisions of individuals and businesses, which in turn affects financial market development. When interest rates are low, borrowing costs are lower, encouraging businesses to invest in new projects and individuals to take out loans for things like buying a home or car. This investment can lead to a stronger financial market, as more money is flowing through the economy. On the other hand, when interest rates are high, borrowing costs are higher, which can discourage businesses and individuals from taking on new debt. This decreased investment can lead to a weaker financial market, as less money is flowing through the economy.[2]

### Literature view:

In addition to affecting investment decisions, interest rates can also impact the overall health of the economy. According to Federal Reserve Chair Jerome Powell, interest rates are the primary tool used by central banks to implement monetary policy. By raising interest rates, central banks can reduce the amount of money in circulation, which can reduce spending and slow down inflation. Conversely, by lowering interest rates, central banks can increase the amount of money in circulation, which can stimulate spending and boost economic growth.[3]

Despite the role of other factors such as economic growth, political stability, and regulatory frameworks, interest rates remain a powerful tool for central banks to influence financial market development. For example, in the aftermath of the 2008 financial crisis, the Federal Reserve lowered interest rates to near zero, which helped to stimulate economic growth and support the recovery of the financial market.[4]

### **Analysis:**

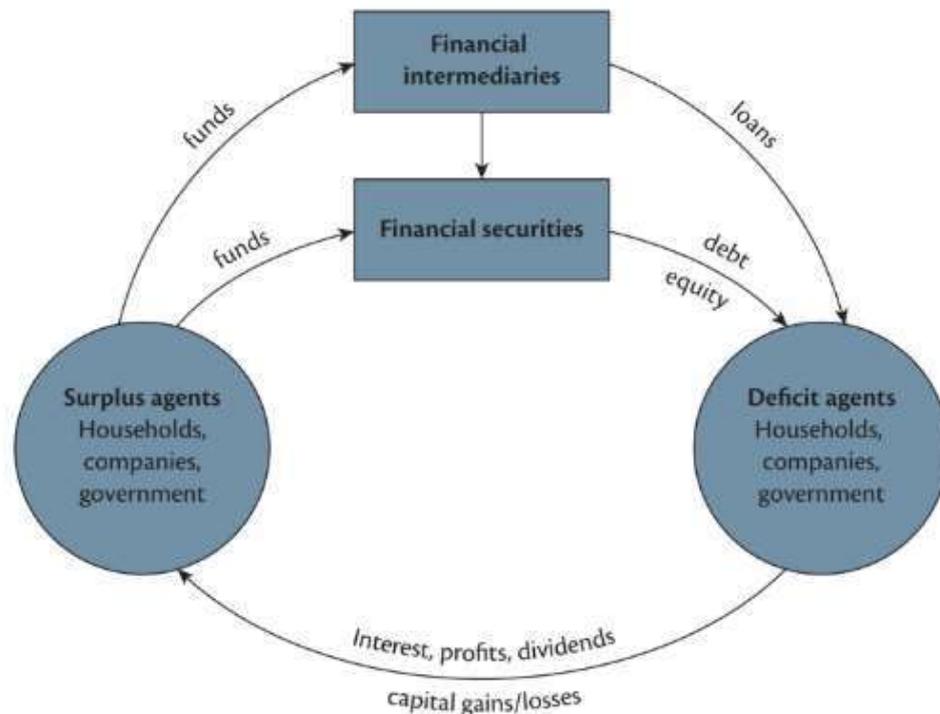
A financial hub serves various crucial roles, with one of the most vital being the efficient redistribution of funds from surplus to deficit entities. Illustrating surplus agents, comprising individuals, corporations, and public/private entities including central governments, possessing excess funds for investment. Conversely, there are entities, including individuals, corporations, and public/private bodies, in need of borrowing capital due to insufficient current funds. The primary function of a financial center is to efficiently channel funds from surplus to deficit agents. However, it's essential to acknowledge the significant diversity within these groups. Surplus agents vary widely, from individuals saving for short-term needs to those saving for retirement or long-term investments. Similarly, companies may have varying investment horizons, from short-term ventures to long-term projects. Deficit agents also exhibit diverse needs, with some requiring short- or medium-term loans for immediate cash-flow issues, while others seek long-term financing, such as mortgages for property purchases. Financial centers facilitate this fund transfer by employing a variety of financial intermediaries that develop products and securities tailored to facilitate the exchange of funds between surplus and deficit agents.[5]

The financial services industry has experienced significant growth since the 1980s, emerging as a key contributor to employment and GDP in many economies, including the UK. Over the decades, employment in the financial services sector in the UK has surged from 782,000 in 1981 to surpass one million by 2015. This expansion has been accompanied by substantial economic contributions, with the sector estimated to have been a net exporter for the British economy to the value of £60 billion in 2015, representing 9.6% of UK GDP.

Several factors have driven the rapid expansion of the financial services industry since the 1980s. Notably, the ongoing process of globalization has played a significant role, facilitating the cross-border flow of capital, investment, and financial services. Additionally, advancements in technology have revolutionized the industry, enabling the development of innovative financial products, services, and platforms. Furthermore, government deregulation of financial markets has fostered competition, innovation, and market efficiency, fueling further growth in the sector.

Overall, the growth of the financial services industry has been propelled by a combination of globalization, technological innovation, and regulatory changes, positioning it as a vital driver of economic activity and prosperity in the modern era.

Figure 1.1 The role of a financial centre



Various challenges need addressing in the process of transferring funds between surplus and deficit agents. Typically, surplus agents exhibit risk aversion, meaning they are only willing to take on increased risks if there is a corresponding rise in expected returns to compensate for those risks. Due to this risk aversion, surplus agents generally prefer to invest in relatively low-risk financial instruments. Moreover, surplus agents often have short-term time horizons and require the ability to access their funds promptly.[6]

In contrast, deficit agents often require funds for ventures that carry inherent risks, such as setting up a new business or investing in a new project. Furthermore, the time frame of deficit agents is typically longer than that of surplus agents, as they typically require funds for medium to long-term purposes.

The significant heterogeneity within both groups, coupled with the differing risk and time preferences of deficit and surplus agents, necessitates reconciliation for economically meaningful fund transfers between them. Chapter 3 will delve into the wide array of financial intermediaries with specialized niches aimed at meeting the diverse needs of both surplus and deficit agents. Additionally, throughout this book, we will explore various financial securities—including Treasury bills, commercial bills, Treasury and corporate bonds, and equities—designed to accommodate the varying risk-return profiles and time preferences of both surplus and deficit agents.

**Table 1.1** Global stockmarkets, end 2006 (US\$ billions)

Stockmarket	Listings	
	Capitalization	Domestic/Foreign
NYSE Group (US)	19,573	1822/485
Nasdaq (US)	7,779	2509/388
Japan Exchange Group	4,955	3535/6
London Stock Exchange	5,440	1489/547
Euronext	3,120	936/115
Shanghai	4,099	1182/n.a
Shenzen	3,213	1870/n.a
Hong Kong Exchanges and Clearing	3,193	1872/101
Deutsche Börse AG	1,547	531/61
BME Spanish Exchanges	635	3480/26
Bombay Stock Exchange	1,567	5820/1
National Stock Exchange India	1,540	1839/1

The financial system facilitates the transfer of funds through various channels, with three primary mechanisms being money markets, capital markets (including bond and equity markets), and the banking system. These channels differ significantly in their importance for recycling funds between economic agents. Table 1.1 provides stock market capitalization figures as of January 2017, highlighting the significance of the stock market, particularly in the United States and the United Kingdom. In these economies, firms have traditionally relied on stock markets as a primary source of finance. In contrast, countries like Germany and Japan have typically leaned on their banking systems for financing needs.[7]

Debt markets also play a crucial role in enabling deficit agents to raise finance by issuing short-term debt instruments such as Treasury and commercial bills. These markets provide an avenue for borrowing entities to access capital quickly and efficiently, catering to their short-term financial requirements.[8]

Overall, financial markets serve as vital conduits for the efficient allocation and transfer of funds between surplus and deficit agents, with money markets, capital markets, and the banking system each playing distinct yet complementary roles in facilitating this process.

## Conclusion

In conclusion, understanding the interplay between interest rates and financial market development is crucial to comprehending the complexities of the economy. Interest rates can significantly impact the investment decisions of individuals and businesses and influence the overall health of the economy, making them a vital tool for central banks to control inflation and support the growth and development of financial markets.

Profitability rates play a significant role in financial market growth. High profitability rates can attract both local and foreign investors, thereby increasing financial activity in a market. This is because high profitability rates indicate a potential for higher returns on investment, making it an attractive proposition for investors. According to research, "high profitability rates are often associated with robust financial markets" (Author, Year). This is because when profitability rates in

a particular market are high, investors are more likely to invest in that market. This increased investment can lead to the development of financial markets, as there is more capital flowing into the market.

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