

6.1: Financial System

The financial system refers to the complex of markets and institutions which help move capital (or cash) from suppliers of capital to demanders of capital, see diagram.

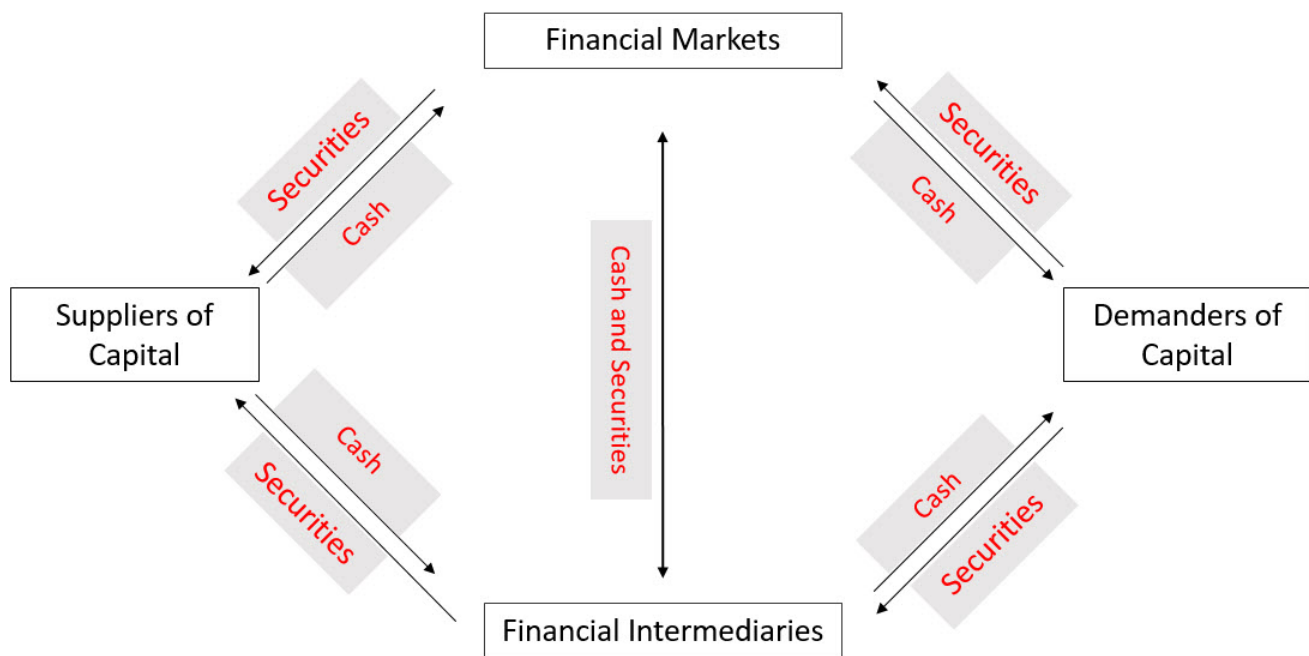


Figure 6.1.1: The financial system

As you can see, capital (cash) flows from suppliers of capital to demanders of capital in several different routes. It can flow through the financial markets (for example, when an investor buys a stock or a bond) or through a financial intermediary (for example, when someone deposits their money in a savings/checking account at the bank). Securities flow from demanders of capital to suppliers of capital (in exchange for cash). For instance, in the example of an investor buying a stock or bond, the investor that is selling the stock is exchanging a security for capital through the financial markets. When you borrow money from the bank to purchase a new car you are exchanging a security (the loan agreement) for cash (to pay the car dealer). Capital and securities also flow both ways between financial intermediaries and financial markets (for instance, banks buy and sell Treasury bonds — sending capital to the financial markets in exchange for securities when buying and sending securities in exchange for capital when selling).

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