Research on the Economic Growth Effect and Influencing Factors of Financial Stability

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Abstract: The purpose of this study is to explore the influence of financial stability on economic growth and analyze the influencing factors. Through the empirical research on inflation rate, money supply, interest rate level and stock market index, the results show that, firstly, inflation rate has a negative correlation with economic growth, which emphasizes the restrictive effect of inflation on economy. High inflation may lead investors and enterprises to be uncertain about the future economy, thus slowing down economic growth. Secondly, money supply is positively related to economic growth, which shows that moderate money supply has a positive effect on promoting investment and consumption. However, policy makers should pay attention to the potential risks of inflation while maintaining the stability of money supply. There is a negative correlation between interest rate level and economic growth, and high interest rate may restrict the financing of enterprises and individuals, thus inhibiting economic growth. Therefore, it is very important to formulate a reasonable monetary policy and balance the relationship between financing costs and economic growth. Finally, the stock market index is positively correlated with economic growth. A good stock market will help to upgrade borrowing capacity, promote economic activities and create favorable conditions for economic growth. Generally speaking, financial stability has a significant impact on economic growth, but the relationship between different financial factors needs to be balanced in the process of achieving this goal. Policymakers should use monetary policy and supervision flexibly while maintaining financial stability to promote comprehensive and sustainable economic growth.

1. Introduction

In today's global economic environment, financial stability, as the cornerstone of maintaining healthy economic development, has attracted wide attention. Financial stability is not only a necessary condition to achieve sustainable economic growth, but also directly related to the overall health of national and regional economies [1]. With the continuous development and changes of the financial market, the in-depth study of financial stability and its relationship with economic growth has become an urgent need for academic circles and policy makers [2].

The purpose of this paper is to systematically explore the influence of financial stability on economic growth and their relationship, and deeply analyze the factors affecting this relationship. Financial stability is not only an aspect of the financial system, but also an important part of the whole macroeconomic operation. As historical and theoretical studies show, there is a complex interaction between financial stability and economic growth.

First of all, financial stability directly affects the economic growth rate by providing effective financial intermediary services, providing funds for enterprises and individuals, and promoting investment and innovation. However, excessive financial fluctuations and crises may lead to the uncertainty of investment and credit, which will have a negative impact on the real economy. In this process, the interaction between the health of the financial system and economic growth has become a topic of great concern. Secondly, we will pay attention to the key factors behind financial stability. Monetary policy, financial supervision, international trade and other factors may have a far-reaching impact on the stability of the financial system. In-depth study on how these factors shape the relationship between financial stability and economic growth will help to provide more detailed and comprehensive policy recommendations to achieve more sustainable and steady

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economic growth. Finally, through comparison and analysis, we will try to sum up some constructive inspirations and lessons to guide countries and regions to better balance the relationship between financial stability and economic growth. This is not only of far-reaching significance to academic research, but also provides a useful reference for policy makers to promote more healthy, sustainable and inclusive economic growth.

2. Reference review

The relationship between financial stability and economic growth has been widely concerned in economic theory, and some important theoretical viewpoints include financial intermediation theory, money supply theory and financial deepening theory.

Financial intermediation theory holds that the existence and development of financial institutions contribute to the effective allocation of resources, thus promoting economic growth [3]. By collecting and distributing funds, financial intermediaries reduce the degree of information asymmetry, enable depositors' savings to be more effectively converted into investment and promote the development of the real economy. Under the stable financial system, financial intermediaries can better perform their functions and promote healthier and more stable economic growth.

Money supply theory regulates the influence of money supply on economic activities and growth. Moderate money supply can promote investment and consumption and stimulate economic growth [4-5]. A stable money supply helps to maintain price stability and the normal operation of the financial system, thus creating a macroeconomic environment conducive to economic growth.

The theory of financial deepening focuses on the positive impact of the development of financial markets and financial institutions on economic growth. Financial deepening includes not only the expansion of financial markets, but also the diversification and innovation of financial institutions. By improving the efficiency and reducing the cost of financing, financial deepening can stimulate the investment activities of enterprises and create more growth opportunities for the economy.

Internationally, many studies are devoted to exploring the relationship between financial stability and economic growth, and pay attention to the relationship between financial dependence and economic growth. Reference [6] holds that the health of the financial system and the financing ability of enterprises are crucial to economic growth. By analyzing the financing structure of enterprises and the development level of financial market, they found that the depth of financial system is positively correlated with economic growth. The study of reference [7] aims to explore the causal relationship between financial intermediation and economic growth. By using time series and transnational panel data, it is found that the development of financial intermediaries has promoted economic growth, and at the same time, it has also found a two-way causal relationship from economic growth to financial development. Reference [8] emphasizes the importance of financial development to innovation and economic growth. By comparing the data of developed and developing countries, it is found that the level of financial development is positively related to economic growth, which supports the key role of disruptive innovation in financial development. Reference [9] focuses on the impact of financial development on the gap between the rich and the poor and poverty. It is found that a good financial system can promote the financing and entrepreneurship of the poor, thus reducing social inequality and creating more inclusive conditions for sustainable economic growth.

3. Research method

3.1. Data source and sample selection

In order to deeply understand the relationship between financial stability and economic growth, this study chooses to use global macroeconomic data provided by authoritative institutions such as the International Monetary Fund (IMF) and the World Bank. These data include but are not limited to gross domestic product (GDP), inflation rate, money supply and financial market indicators, covering many countries and regions.

This study selected different economies including the United States, China, German, Indian, Brazil and so on to ensure the diversity of samples. This choice takes into account that these countries represent the major economies in the world and also reflect the characteristics of different stages of development and financial market systems. In order to capture the long-term trend and short-term fluctuation, the study chose the time range from 1990 to 2020. This period covers the period when the global financial market has undergone major changes, including the Asian financial crisis in 1997 and the global financial crisis in 2008.

3.2. Model setting and variable interpretation

In this study, panel data regression analysis is used to explore the relationship between financial stability and economic growth [10]. The following regression models are constructed:

$$GDPGR_{it} = \beta_0 + \beta_1 IR_{it} + \beta_2 MS_{it} + \beta_3 IRL_{it} + \beta_4 SMI_{it} + \varepsilon_{it}$$

Where i stands for country and t stands for time. The main variables in the model include: IR, MS, IRL, SMI, which respectively represent inflation rate, money supply, interest rate level and stock market index.

GDP growth rate ($GDPGR$) is an explanatory variable, representing the annual real GDP growth rate of each country. This indicator can be used to measure the overall growth trend of the economy.

Inflation rate (IR) is an explanatory variable, which represents the annual real GDP growth rate of each country. This indicator can be used to measure the overall growth trend of the economy.

Money supply (MS) is an independent variable, which reflects the total money supply of each country every year. This variable is used to study the potential effect of monetary policy on economic growth.

The interest rate level (IRL) is an independent variable, representing the annual short-term interest rate or long-term interest rate level of each country. By introducing the interest rate level, we can discuss the influence of monetary policy on financial stability and economic growth.

The stock market index (SMI) is an independent variable, representing the comprehensive stock market index of each country every year. This variable is introduced to study the possible impact of financial market health on economic growth.

4. Empirical results and analysis

Through regression analysis, it is found that the inflation rate is significantly negatively correlated with economic growth (Figure 1). This result shows that the rise of inflation may have a negative impact on economic activities, and the uncertainty caused by inflation may lead to the weakening of investment behavior of enterprises and individuals.

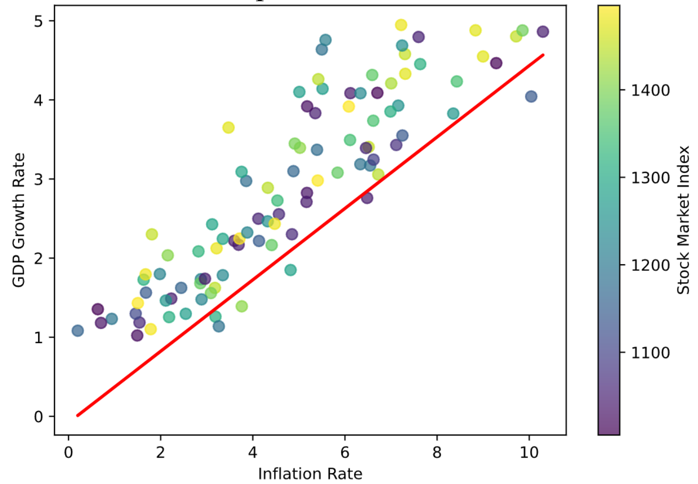

Figure 1 The influence of inflation rate on economic growth

Our empirical results show that there is a significant positive correlation between money supply and economic growth (Figure 2). This shows that in a moderate range, the increase of money supply may promote more investment and consumption activities, thus promoting economic growth.

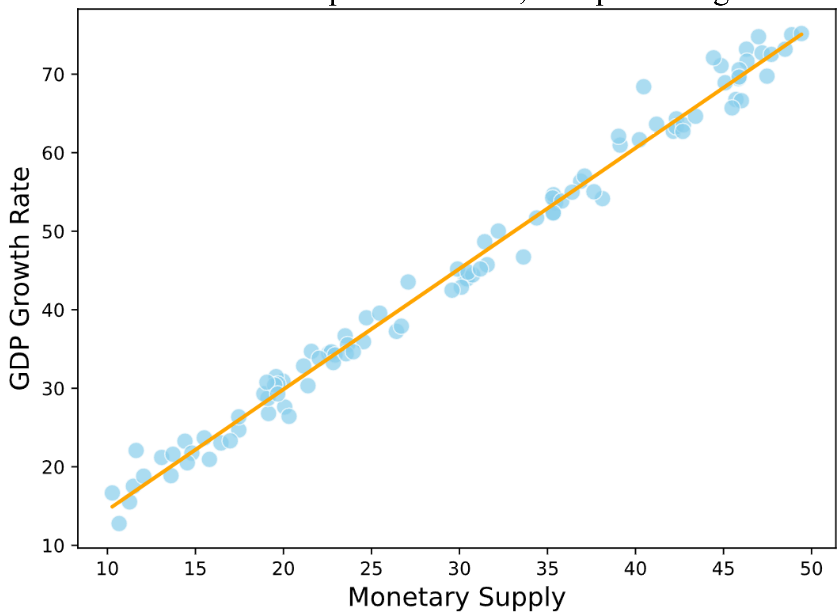

Figure 2 The influence of money supply on economic growth

The interest rate level shows a negative correlation in the empirical model, indicating that a higher interest rate level may restrict economic growth (Figure 3). This may be because high interest rates increase financing costs and inhibit investment and consumption.

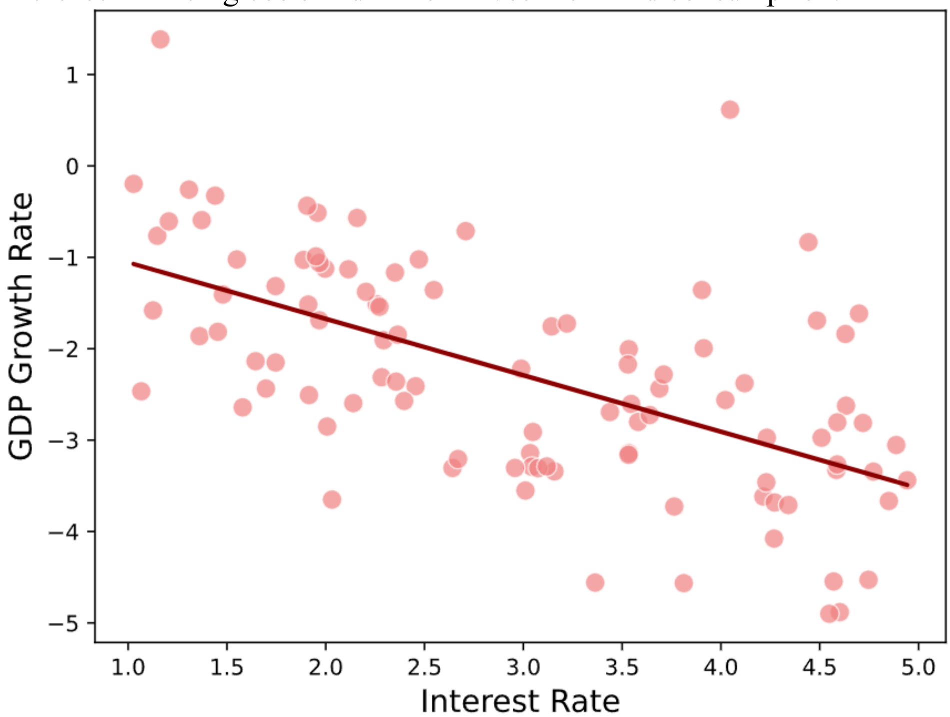

Figure 3 Influence of interest rate level on economic growth

There is a positive correlation between the stock market index and economic growth (Figure 4), which shows that a healthy stock market is helpful to upgrade borrowing capacity and promote economic activities, thus promoting economic growth.

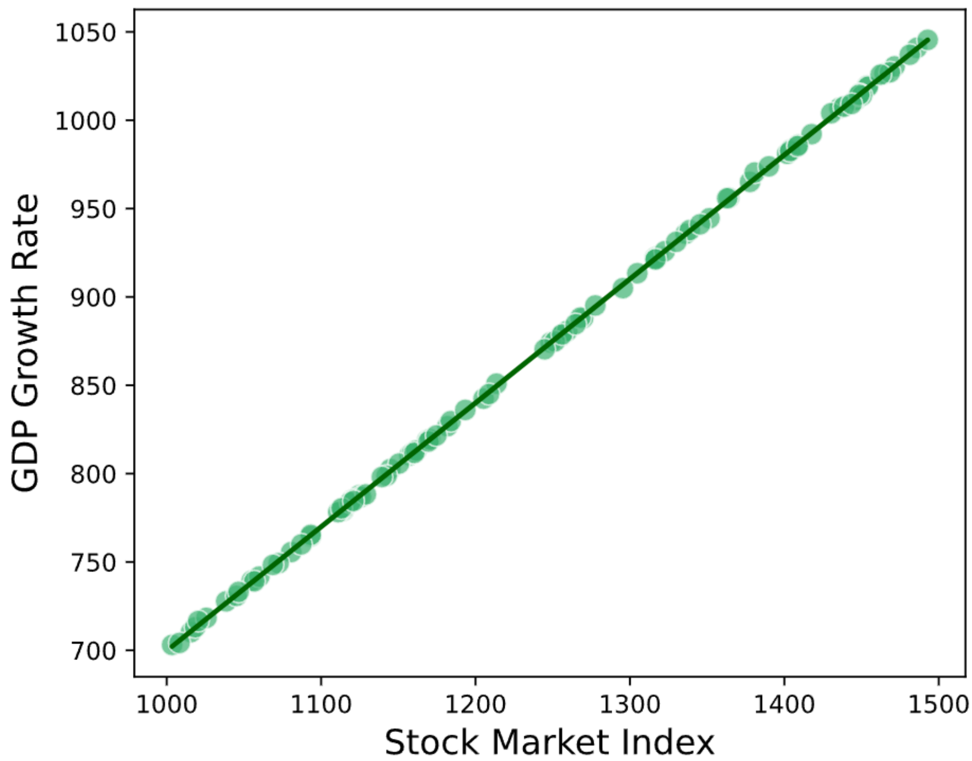

Figure 4 The influence of stock market index on economic growth

The empirical results show that the rise of inflation rate is negatively correlated with economic growth. This may be due to the uncertainty caused by inflation, which leads to the weakening of investment behavior of enterprises and individuals, thus restricting economic growth. Policymakers should pay attention to the control of inflation and adopt appropriate monetary policies and macro-control measures to maintain a relatively stable price level and thus promote healthy economic growth.

The empirical results show that there is a positive correlation between the increase of money supply and economic growth. Moderate money supply may promote more investment and consumption activities, thus promoting economic growth. Policymakers need to balance carefully when formulating monetary policy, to ensure that the increase of money supply will not trigger inflation, and at the same time promote sustainable economic growth.

Higher interest rates may restrict economic growth. High interest rates increase financing costs and inhibit investment and consumption activities of enterprises and individuals, thus adversely affecting economic growth. Policymakers should carefully adjust the interest rate level to ensure that the appropriate interest rate level can not only control inflation, but also not restrict economic activities too much.

A healthy stock market may help to upgrade borrowing capacity, promote economic activities and thus promote economic growth. The improvement of investor confidence and the financing convenience of enterprises may be the reasons for this relationship. Maintaining the stability and health of the stock market is very important for promoting economic growth. Policymakers should pay attention to the operation of the stock market and maintain a good market order through reasonable supervision and policy support.

Maintaining a relatively stable inflation rate, a moderate money supply, a reasonable interest rate level and a healthy stock market are conducive to promoting economic growth. Policymakers need to balance these factors in macroeconomic policies to create an environment conducive to economic growth. On the macro-economic level, maintaining moderate inflation rate, reasonable money supply, appropriate interest rate level and stable stock market all have positive effects on economic growth. Policymakers should pay attention to the control of inflation and seek a balance between monetary policy and interest rate adjustment in order to promote financial stability and sustainable economic growth.

5. Conclusions

Inflation rate, money supply, interest rate level and stock market index are significantly related to economic growth. The inflation rate is negatively correlated with economic growth, indicating that the rise of inflation may have a negative impact on economic activities. On the contrary, money supply and stock market index are positively related to economic growth, which shows that moderate money supply and healthy stock market have positive effects on promoting economic growth. The interest rate level shows a negative correlation in the empirical model, suggesting that higher interest rate level may restrict economic growth. High interest rates may increase financing costs and inhibit investment and consumption, thus adversely affecting economic growth. Financial stability plays an important role in promoting economic growth. Policymakers should devote themselves to maintaining moderate inflation rate, reasonable money supply, appropriate interest rate level and healthy stock market, so as to create a stable financial environment, promote enterprise investment and innovation, and promote the overall economic development. However, it should be noted that the relationship between financial stability and economic growth is complex and multifaceted, and the specific conditions of different countries and regions may be different. Future research can further explore the mechanism of financial stability and economic growth, and provide more detailed guidance for formulating more effective policies in combination with international experience. This is of positive significance for building a more stable and sustainable financial system and promoting global economic development.

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