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FUNCTIONS OF THE CREDIT MECHANISM AND MONEY CIRCULATION IN THE FINANCIAL SYSTEM

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Abstract: The credit mechanism and money circulation play a pivotal role in ensuring the stability and efficiency of the financial system. This study explores the primary functions of credit, including facilitating investment, stimulating economic growth, and regulating liquidity within the economy. In parallel, money circulation is analyzed as a key process that ensures the smooth functioning of transactions, price stability, and effective allocation of resources. The paper emphasizes the interdependence between credit and money flows, highlighting their significance in maintaining economic balance and promoting sustainable development. By examining theoretical frameworks and practical examples, the research provides insights into how credit and money circulation contribute to the overall functionality of the financial system.

Keywords: Credit mechanism, money circulation, financial system, liquidity, economic growth, financial stability.

Introduction. The financial system is the foundation of a modern economy, encompassing institutions, markets, instruments, and mechanisms that facilitate the flow of funds between savers and borrowers. Among the key components that determine the efficiency and stability of the financial system are the credit mechanism and money circulation. The credit mechanism is a fundamental tool that enables the mobilization and allocation of financial resources, provides loans and other forms of credit, and supports investment activities in various sectors of the economy. By allowing businesses and individuals to access necessary capital, the credit system stimulates production, encourages entrepreneurship, and promotes overall economic growth. Money circulation, on the other hand, refers to the continuous movement of money within the economy, including cash transactions, digital payments, and interbank transfers. Efficient money circulation ensures that liquidity is maintained, transactions are executed smoothly, and the purchasing power of the population is stabilized. Without proper circulation of money, the economy can face bottlenecks, inflationary pressures, or a slowdown in trade and production. The interrelationship between credit and money circulation is especially significant. Credit provides additional liquidity and creates new purchasing power, which in turn enhances the velocity of money within the economy. Conversely, effective money circulation creates a stable financial environment that encourages lending and borrowing activities. Both mechanisms are therefore mutually reinforcing, contributing to economic stability and enabling the government and financial institutions to implement monetary and fiscal policies effectively. In addition, the functions of credit and money circulation extend beyond economic growth. They play a critical role in redistributing financial resources, supporting social programs, and maintaining financial stability during economic fluctuations.

Literature review. The credit mechanism and money circulation are widely discussed in financial and economic literature, as they are central to the functioning of any financial system.

Numerous scholars have explored the roles, functions, and interrelations of these mechanisms in ensuring economic stability and growth. According to Mishkin and Eakins (2018), credit serves as a fundamental instrument for mobilizing financial resources, allowing households, firms, and governments to borrow funds for investment and consumption purposes. Credit, they argue, not only facilitates economic activities but also contributes to the development of financial markets by improving liquidity and enabling risk-sharing among economic agents. By providing access to financial resources, the credit mechanism stimulates entrepreneurship, encourages innovation, and fosters long-term economic growth [1]. Scholars such as Keynes (1936) and contemporary researchers emphasize the importance of money circulation in maintaining economic equilibrium. Money circulation ensures the smooth execution of transactions, stabilizes prices, and allows for effective allocation of resources within the economy. The velocity of money—the speed at which money changes hands—is directly influenced by credit availability, suggesting a strong interdependence between money circulation and the credit system [2]. Further research by Diamond and Dybvig (1983) highlights the role of banks and other financial intermediaries in bridging the gap between savers and borrowers. Banks facilitate credit creation and promote the circulation of money by offering loans and managing deposits. Efficient banking operations, therefore, enhance liquidity and reduce the risk of financial instability [3]. Other studies focus on the macroeconomic implications of credit and money circulation. For instance, Bernanke and Blinder (1988) examine how changes in credit supply affect aggregate demand, investment, and consumption patterns. They argue that a well-functioning credit system can act as a stabilizer during economic downturns by providing necessary liquidity to businesses and households. Similarly, Mishkin (2007) emphasizes that money circulation is critical for implementing monetary policies, as central banks regulate liquidity to control inflation, interest rates, and economic growth [4]. Regional studies also provide insights into the role of credit and money circulation in developing economies. Research on emerging markets demonstrates that underdeveloped credit markets or inefficient money circulation can hinder investment, reduce economic growth, and exacerbate income inequalities. In such contexts, policy interventions aimed at improving banking infrastructure, promoting financial literacy, and facilitating access to credit have proven effective in stimulating economic development [5]. Overall, the literature indicates a clear consensus: the credit mechanism and money circulation are mutually reinforcing components of the financial system. While credit provides the necessary capital for economic activities, money circulation ensures liquidity and the smooth functioning of transactions. Both mechanisms contribute not only to economic growth but also to financial stability and sustainable development.

Research Methodology. This study employs a qualitative and analytical research methodology to examine the functions of the credit mechanism and money circulation in the financial system. The primary research materials include academic books, scholarly articles, government reports, and case studies on credit systems, banking operations, and money flow within various economies. The study applies descriptive and comparative analysis methods to evaluate how credit facilitates investment, economic growth, and liquidity management, as well as how money circulation supports transactions, price stability, and resource allocation. In addition, the research uses a systematic review approach to analyze theoretical frameworks and empirical findings from previous studies, highlighting the interrelationship between credit and money circulation.

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By combining literature review with analytical interpretation, the study provides a comprehensive understanding of the roles and significance of credit and money circulation in maintaining financial stability and promoting sustainable economic development.

Table 1. Functions of the credit mechanism in the financial system

Function of Credit	Description	Economic Impact
Mobilization of Funds	Aggregates savings from households and firms for productive use	Increases capital availability for investment and economic growth
Facilitation of Investment	Provides loans for business expansion, technology, and infrastructure	Encourages entrepreneurship and innovation
Risk Sharing	Distributes financial risks among borrowers and lenders	Reduces financial uncertainty and promotes economic stability
Liquidity Provision	Ensures funds are available for short-term needs	Supports smooth operation of markets and reduces liquidity crises
Economic Growth Stimulation	Encourages consumption and investment through accessible credit	Enhances overall productivity and national income

Table 2. Functions of money circulation in the financial system

Function of money circulation	Description	Economic impact
Facilitation of Transactions	Ensures smooth flow of money between buyers and sellers	Supports trade, business activities, and daily transactions
Liquidity Maintenance	Keeps funds available for economic agents	Prevents liquidity shortages and ensures operational continuity
Price Stability	Maintains consistent purchasing power of money	Reduces inflationary or deflationary pressures
Support for Monetary Policy	Enables central banks to control money supply and interest rates	Helps stabilize economy and implement fiscal and monetary interventions
Resource Allocation	Directs funds to priority sectors through effective circulation	Encourages efficient use of financial resources

The two tables presented above provide a clear and structured overview of the functions of the credit mechanism and money circulation within the financial system. Table 1 illustrates the multifaceted roles of credit, including fund mobilization, facilitation of investment, risk sharing,

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liquidity provision, and stimulation of economic growth. By summarizing these functions, the table highlights how credit acts as a critical tool for enabling financial resources to reach productive uses, encouraging entrepreneurship, and supporting the overall stability of financial markets. For instance, the provision of loans for infrastructure or business expansion not only promotes investment but also enhances national income and productivity. Table 2 focuses on the functions of money circulation, such as facilitating transactions, maintaining liquidity, stabilizing prices, supporting monetary policy, and ensuring efficient resource allocation. The table emphasizes that effective money circulation is essential for smooth economic operations, as it guarantees the availability of funds for households and businesses, supports trade, and prevents liquidity shortages. Moreover, by maintaining price stability and enabling the implementation of monetary policies, money circulation directly reinforces the effectiveness of the credit mechanism. Overall, the analysis of these tables demonstrates the interdependent nature of credit and money circulation. Credit creates additional purchasing power, which accelerates money circulation, while efficient circulation ensures that financial institutions can extend further credit. Together, these mechanisms support economic growth, enhance liquidity, stabilize prices, and contribute to the sustainability of the financial system. By presenting the information in tabular form, the study provides a concise and accessible way to understand the core functions and economic impacts of credit and money circulation.

Research discussion. The analysis of the credit mechanism and money circulation reveals their crucial role in maintaining the efficiency and stability of the financial system. Credit serves as the backbone of economic activity by enabling individuals, businesses, and governments to access funds necessary for investment, consumption, and operational purposes. Through the provision of loans, overdraft facilities, and other credit instruments, financial institutions facilitate the mobilization of financial resources, which in turn stimulates production, innovation, and economic growth. Moreover, credit provides a channel for risk-sharing among economic agents, allowing businesses to expand while managing financial uncertainties [1]. Money circulation, as another key component, ensures that funds continuously move within the economy, facilitating transactions and supporting liquidity. A well-functioning money circulation system enables the efficient exchange of goods and services, stabilizes prices, and supports the implementation of monetary policies. The velocity of money, which measures the rate at which money changes hands, is strongly influenced by the availability of credit. Increased credit availability can accelerate money circulation by creating additional purchasing power, whereas insufficient credit supply can slow down economic activities and reduce market efficiency [2]. The interrelationship between credit and money circulation is particularly significant. Credit creation by banks increases the money supply and encourages spending, which in turn strengthens circulation. Conversely, effective money circulation provides the liquidity necessary for banks and financial institutions to extend further credit. This mutually reinforcing relationship highlights the importance of synchronizing credit policies and money circulation mechanisms to maintain financial stability. For example, during periods of economic slowdown, central banks can use credit expansion to increase liquidity, stimulate demand, and support economic recovery. Similarly, in times of inflation, controlling money circulation and credit supply can prevent overheating of the economy [3]. Empirical studies from emerging markets demonstrate that underdeveloped credit systems or inefficient money circulation can hinder investment and economic growth. For instance, restricted access to credit limits entrepreneurial activities, while irregular money flows can lead to liquidity shortages, reduced consumption, and price volatility. In contrast, countries with well-developed credit markets and efficient money circulation experience higher levels of investment, greater employment opportunities, and stable economic growth. This emphasizes that policymakers must pay close attention to the design and regulation of credit systems and the management of money circulation to ensure long-term economic sustainability [4]. Furthermore, credit and money circulation serve broader socio-economic functions. By directing credit to priority sectors, financial institutions can support strategic development goals, technological advancement, and social programs.

Conclusion. The study demonstrates that the credit mechanism and money circulation are fundamental components of the financial system, playing a critical role in ensuring economic growth, financial stability, and sustainable development. Credit facilitates the mobilization and allocation of financial resources, enabling households, businesses, and governments to access funds for investment, consumption, and operational purposes. It promotes entrepreneurship, innovation, and risk-sharing while supporting the overall functioning of financial markets. Money circulation, on the other hand, ensures the continuous flow of funds within the economy, facilitating transactions, stabilizing prices, and maintaining liquidity. The interrelationship between credit and money circulation is mutually reinforcing: credit increases liquidity and purchasing power, which enhances money circulation, while effective circulation ensures that financial institutions have the resources to provide further credit. This synergy contributes to economic stability and supports the implementation of monetary and fiscal policies. Empirical and theoretical evidence indicates that underdeveloped credit systems or inefficient money circulation can hinder investment, reduce economic growth, and exacerbate financial instability.

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