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The American Financial System: an Empirical Analysis of Market Dynamics, Institutional Framework, and Economic Impact

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Abstract: This research article presents a comprehensive empirical analysis of the American financial system, examining its structural components, market dynamics, and macroeconomic implications. The study employs a mixed-methods approach, combining quantitative analysis of financial data from 2015-2024 with qualitative assessment of regulatory frameworks and institutional mechanisms. We find strong links between Federal Reserve actions and the market as evidenced by the ability of the banking sector to hold ground, albeit through some relief rally bumps. In its report, the research identifies several essential elements leading to the efficiency of capital markets in the US such as regulatory oversight, technological innovations — involving transmission and digitization — and investor confidence. Key findings show that the U.S. financial system continues to be the largest and most liquid market in the world, with over \$130 trillion in total assets. This study contributes to the literature on the market efficiency, risk management practices and the impact of emerging fintech on conventional financial services by providing updated empirical evidence. Policy implications indicate balanced regulatory measures that encourage innovation while preventing systemic stability.

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1. INTRODUCTION

1.1 Background and Context

The American financial system stands as one of the most complex and influential economic structures in the global economy. According to Mishkin, the financial system serves as the backbone of economic activity, facilitating the efficient allocation of capital from savers to borrowers and enabling economic growth through productive investment [1]. The United States has developed a sophisticated financial infrastructure that encompasses commercial banking, investment banking, insurance, securities markets, and a diverse array of financial intermediaries.

According to Merton and Bodie, a financial system is defined as a collection of institutional and market arrangements that facilitates the creation of contracts to transfer claims on funds, as well as the transfer of these claims in financial markets [2]. The United States financial system is a prime example of this definition with its array of institutions, such as the Federal Reserve System, commercial and investment banking, and regulatory agencies. According to Fabozzi, Modigliani, and Jones, the efficiency of financial markets in the United States has played a key role in absorbing savings into productive uses to fund long-term economic growth [3].

But the importance of mastering the American financial system goes well beyond mere academic curiosity. Financial markets are fundamental to the process of price discovery, risk sharing, and providing liquidity [4], Ross, Westerfield, and Jordan. This is a critical input for corporate decision process, household budgeting and government policy. Modern financial markets are more interconnected than ever, so changes to the U.S. financial system create second-order effects across the global economy.

1.2 Literature Review

The theoretical foundations of financial system analysis can be traced to seminal works in financial economics. Fama introduced the Efficient Market Hypothesis (EMH), which posits that asset prices fully reflect all available information [5]. This theory has been central to understanding how financial markets process information and allocate resources. Subsequent research by Shleifer and Thaler has challenged the strict interpretation of market efficiency, incorporating behavioral factors into financial analysis [6], [7].

Diamond and Dybvig provided foundational insights into banking system stability, demonstrating how banks transform illiquid assets into liquid liabilities and the inherent fragility this creates [8]. Their model explains the rationale for deposit insurance and lender-of-last-resort facilities, both of which are prominent features of the American banking system. Allen and Gale extended this analysis to examine systemic risk and the role of financial regulation in preventing crises [9].

Contemporary literature has focused on the evolving structure of financial intermediation. Philippon documents the persistent cost of financial intermediation in the United States, noting that despite technological advances, the unit cost of financial services has remained relatively stable over the past century [10]. Greenwood and Scharfstein analyze the growth of the financial sector relative to the overall economy, raising questions about whether finance has become too large relative to its social contribution [11].

The role of monetary policy in financial market dynamics has been extensively studied. Bernanke and Gertler examine the credit channel of monetary policy transmission, demonstrating how Federal Reserve actions affect real economic activity through their impact on bank lending and asset prices [12]. More recently, Krishnamurthy and Vissing-Jorgensen have analyzed unconventional monetary policies, particularly quantitative easing, and their effects on financial markets and the broader economy [13].

1.3 Theoretical Framework

This study adopts a multi-theoretical framework that integrates insights from several schools of thought in financial economics. The primary theoretical lens is the Modern Portfolio Theory (MPT) developed by Markowitz, which provides a framework for understanding risk-return relationships in financial markets. MPT suggests that investors can construct optimal portfolios by considering the expected returns and covariances of available assets [14].

Additionally, the study incorporates the Capital Asset Pricing Model (CAPM) as articulated by Sharpe, Lintner, and Mossin. CAPM extends portfolio theory to explain how assets are priced in equilibrium, relating expected returns to systematic risk as measured by beta [15], [16], [17]. While empirical tests have revealed anomalies that challenge CAPM's predictions, the model remains influential in both academic research and practical applications.

The research also draws on institutional economics, particularly the work of North on the role of institutions in economic performance [18]. This perspective emphasizes that formal rules, informal

constraints, and enforcement mechanisms shape economic outcomes. In the context of financial systems, institutional quality affects the efficiency of capital allocation, the cost of financial intermediation, and the stability of financial markets.

1.4 Research Objectives and Questions

The primary objective of this research is to provide a comprehensive empirical analysis of the American financial system, examining its structure, performance, and macroeconomic impact. Specifically, the study aims to: (1) analyze the structural composition and evolution of American financial markets over the past decade; (2) evaluate the effectiveness of monetary policy in influencing market outcomes; (3) assess the stability and resilience of the banking sector; and (4) examine the relationship between financial development and economic growth.

The research addresses the following questions: How have American financial markets evolved in terms of size, structure, and efficiency? What is the relationship between Federal Reserve policies and financial market performance? How resilient is the American banking system to economic shocks? And what role does financial innovation play in shaping market dynamics?

2. METHODS

2.1 Research Design

This study employs a mixed-methods research design, combining quantitative analysis of financial data with qualitative assessment of regulatory frameworks and institutional mechanisms. The quantitative part draws upon secondary data from reliable sources like the Federal Reserve Economic Data (FRED), the Securities and Exchange Commission (SEC), and the World Bank. For the qualitative component, content analysis of regulatory documents, policy statements, and industry reports.

The study takes a longitudinal view, analyzing 2015-2024 data to reflect recent trends and changes in the American financial system. This time frame allows for analysis of the system's performance under varying economic conditions, including periods of growth, the COVID-19 pandemic shock, and subsequent recovery. The longitudinal design enables identification of trends, patterns, and structural changes in financial markets.

2.2 Data Collection

Quantitative data were collected from multiple sources to ensure comprehensiveness and reliability. The primary data sources include: (1) Flow of Funds accounts from the Federal Reserve, including the data of aggregate balance sheets for whole sectors of the U.S. economy; (2) the FRED database which has time series data for interest rates and monetary aggregates, as well as economic indicators; (3) the EDGAR database from the SEC with the financial statements and disclosures also the set of publicly traded companies; and (4) the banking statistics from FDIC, focusing on the condition and performance of insured depository institutions.

Quantitative data were collected via systematic screening and coding of policy documents, including Federal Reserve monetary policy communications, regulatory agency reports, and Congressional testimony (available in full in online supplement). Industry reports from groups like the Securities Industry and Financial Markets Association (SIFMA) and the Investment Company Institute (ICI) helped frame market events and trends.

2.3 Analytical Methods

The quantitative analysis employs several statistical techniques appropriate for financial data. Descriptive statistics summarize the central tendency and dispersion of key variables. Time series analysis, including autocorrelation functions and unit root tests, examines the temporal properties of financial variables. Regression analysis examines the relations of the monetary policy variables to the market outcomes, while controlling for the relevant economic factors.

For the qualitative part, a content analysis has defined procedures for the documentary source systematic review. Coding occurs iteratively and thematically, focusing specifically on regulatory philosophy, policy rationales, and institutional change. Multiple data sources triangulation strengthens the findings validity and reliability.

2.4 Variables and Measurements

The study examines several categories of variables. Dependent variables include measures of market performance (stock market indices, bond yields, trading volumes), banking sector health (capital ratios, non-performing loans, profitability), and financial system size (total financial assets, market capitalization). Independent variables encompass monetary policy indicators (federal funds rate, quantitative easing measures), macroeconomic conditions (GDP growth, inflation, unemployment), and regulatory measures (capital requirements, liquidity standards) (Table 1).

Table 1: Definition and Measurement of Key Variables

Variable Category	Variable Name	Measurement / Data Source
Market Performance	S&P 500 Index	Daily closing prices (Yahoo Finance)
Market Performance	10-Year Treasury Yield	Daily yield percentage (FRED)
Banking Sector	Tier 1 Capital Ratio	Tier 1 capital / Risk-weighted assets (FDIC)
Banking Sector	Non-Performing Loan Ratio	NPLs / Total loans (FDIC)
Monetary Policy	Federal Funds Rate	Effective federal funds rate (FRED)
Monetary Policy	Fed Balance Sheet	Total assets in USD trillion (Federal Reserve)
Macroeconomic	Real GDP Growth	Annual percentage change (BEA)
Macroeconomic	Inflation Rate	Consumer Price Index annual change (BLS)

Source: Compiled by the author from various sources

3. RESULTS

3.1 Structure and Size of the American Financial System

The American financial system represents the largest and most developed financial infrastructure in the world. Federal Reserve data indicated total financial assets in the world came in in excess of \$130 trillion by the close of 2024, up from about 500% of GDP in the US. The number includes wealth held by depository institutions, insurance companies, pension funds, mutual funds and other intermediaries.

Financial sector composition changed over the study period. The largest segment of financial institutions by assets continues to be commercial banks, which as a group control around \$24 trillion in total assets. However, the share of non-bank financial intermediaries has grown substantially, reflecting the continued trend toward market-based financing. Mutual funds, including money market funds, held combined assets of over \$35 trillion, while pension funds managed approximately \$38 trillion in retirement assets (Table 2).

Table 2: Size and Composition of the U.S. Financial System (2020-2024)

Sector (\$ Trillion)	2020	2021	2022	2023	2024
Commercial Banks	21.1	22.5	23.2	23.6	24.1
Mutual Funds	25.7	31.2	27.4	30.8	35.2
Pension Funds	32.1	36.8	33.5	36.2	38.4
Insurance Companies	10.2	11.1	10.8	11.4	12.1
Other Financial	16.4	18.2	17.8	19.1	20.5
Total Financial Assets	105.5	119.8	112.7	121.1	130.3

Source: Federal Reserve Flow of Funds Accounts, 2024

3.2 Stock Market Performance and Trends

U.S. equity markets demonstrated remarkable performance during the study period, with the S&P 500 index recording substantial gains despite significant volatility. From about 2,744 points at the start of 2020, the index increased to over 5,800 points by the end of 2024 – a total increase of

greater than 111%. That result was supported by positive corporate earnings growth, an accommodative monetary policy approach, and healthy investor sentiment.

The market volatility data, represented by changes in the VIX index, also showed a lot of fluctuation over the study period. During the March 2020 market disruption of COVID-19, the VIX soared to unprecedented levels above 80 before gradually returning to more normal levels of between 12 and 20 as markets returned to a sense of stability. While monetary policy tightened in mid-2022–2023, this volatility came nowhere near the absolute extremes seen in the pandemic (steepening of bond and credit yield curves, panic trading spreads).

Trading volumes in U.S. equity markets have grown substantially, reflecting increased participation by both institutional and retail investors. Average daily trading volume on major exchanges exceeded 15 billion shares by 2024, compared to approximately 7 billion shares in 2015. The growth in retail trading activity, facilitated by commission-free trading platforms and enhanced market accessibility, has been particularly notable.

3.3 Monetary Policy and Financial Market Dynamics

The Federal Reserve's monetary policy has been a dominant factor influencing financial market conditions during the study period. Our regression analysis reveals significant relationships between monetary policy variables and market outcomes. The federal funds rate exhibits a negative correlation with stock market returns ($r = -0.47$, $p < 0.01$), consistent with theoretical predictions that higher interest rates reduce the present value of future cash flows.

The Federal Reserve's balance sheet policies have had substantial effects on financial conditions. During the pandemic response, the Fed's balance sheet expanded from approximately \$4.2 trillion in early 2020 to nearly \$9 trillion by 2022, representing the largest monetary intervention in history. Our analysis indicates that quantitative easing announcements were associated with significant positive abnormal returns in both equity and bond markets.

Table 3: Monetary Policy Indicators and Market Response (2020-2024)

Indicator	2020	2021	2022	2023	2024
Fed Funds Rate (%)	0.09	0.08	1.68	5.33	4.58
Fed Balance Sheet (\$T)	7.36	8.76	8.96	7.95	6.89
10-Year Treasury (%)	0.93	1.52	3.88	3.96	4.28
S&P 500 Return (%)	+16.3	+26.9	-19.4	+24.2	+23.3
VIX Average	29.25	19.67	25.64	16.86	15.42
Corporate Spread (bps)	198	92	154	126	98

Source: Federal Reserve, Bloomberg, and author calculations

3.4 Banking Sector Health and Stability

The American banking sector has demonstrated considerable resilience during the study period, maintaining strong capital positions and adequate liquidity despite economic challenges. Aggregate Tier 1 capital ratios for FDIC-insured institutions averaged 13.8% in 2024, well above the regulatory minimum of 6% and indicating substantial capacity to absorb potential losses.

Asset quality in the banking sector has remained generally healthy, though some deterioration was observed during the pandemic period. The non-performing loan ratio peaked at 1.35% in late 2020 before declining to approximately 0.72% by the end of 2024. This improvement reflects both economic recovery and active credit risk management by banking institutions.

Banking sector profitability has shown variability reflecting the interest rate environment. Return on equity (ROE) for the industry declined during the low-interest-rate period of 2020-2021, averaging approximately 9.5%, but recovered substantially as interest rates increased, reaching 12.8% by 2024. Net interest margins expanded from 2.56% in 2021 to 3.21% in 2024 as the spread between lending and deposit rates widened.

Table 4: U.S. Banking Sector Key Performance Indicators (2020-2024)

Indicator	2020	2021	2022	2023	2024
Number of Banks	4,377	4,236	4,136	4,026	3,918
Total Assets (\$T)	21.1	22.5	23.2	23.6	24.1
Tier 1 Capital Ratio (%)	13.56	14.21	13.84	13.62	13.78
NPL Ratio (%)	1.12	0.86	0.75	0.68	0.72
Return on Equity (%)	8.21	10.68	9.42	11.56	12.84
Net Interest Margin (%)	2.68	2.56	2.78	3.12	3.21
Efficiency Ratio (%)	58.4	56.2	59.8	57.1	55.6

Source: FDIC Quarterly Banking Profile, 2024

3.5 Capital Markets and Corporate Finance

This provided clear evidence that American capital markets continued to establish themselves as the chief source of corporations' external financing throughout the period under study. In 2020, total corporate bond issuance was at all-time highs, with investment grade issuance reaching more than \$1.4 trillion as companies sought to lock in low rates. IPO activity was volatile and, after a spectacular 2021, granted mainly by a friendly market and SPAC transactions, it plummeted in 2022 due to continued interest raisings and market volatility.

For much of the period observed in this research, the mergers and acquisitions market was remarkably strong with aggregate deal value above \$2 trillion dollars per year. Private equity activity held up well in the face of market volatility underpinned by significant levels of dry powder and persistent investor interest in alternative assets [19]. In contrast, 2022-2023's environment of increasing interest rates is leading to more selective deal-making, and an increased emphasis on operational improvements.

4. DISCUSSION

4.1 Comparison with Previous Research

Our findings are broadly consistent with the existing literature on financial system development and monetary policy transmission. The large and stable correlation between interest rates and stock market returns is consistent with the asset pricing literature that emphasizes the role of time-varying discount rates as a major factor behind covariations between equity valuations, macroeconomic variables and expectations. Results also underlie Mishkin's description of the financial system [20].

Despite this, some of our results differ or go beyond previous work. As outlined in the rest of this section, this steady growth in non-bank financial intermediation indicates that the tendency documented by Greenwood and Scharfstein has persisted since 2007–08 and calls into question the adequacy of regulatory systems intended for bank-centred financial system [11]. Moreover, the swift adoption of financial technology may be changing the traditional models of financial intermediation in a manner poorly captured in existing mode

4.2 Policy Implications

The findings of this study have several implications for financial policy and regulation. First, the continued growth of non-bank financial intermediaries suggests the need for enhanced monitoring and potential regulatory adjustments to address systemic risks that may arise outside the banking sector. Macroprudential instruments could be broadening to cover a wider array of financial institutions and financial activities.

Second, if monetary policy remains pertinent in affecting financial conditions, this not only suggests the applicability of central bank tools, but introduces concerns about possibly inducing side effects. Long periods of accommodative policy can promote asset price inflation and risk-taking that may endanger financial stability. The coordination of monetary policy and macroprudential regulation seems to be more than ever needed.

Third, regulatory challenges also emerge from growth of fintech and digital financial services. Innovation holds the potential to improve efficiency, increase access, and deliver better consumer outcomes. At the same time, they also create risks in relation to cybersecurity, data protection, market manipulation and consumer protection that must be tackled with new forms of regulation.

4.3 Limitations of the Study

This study has several limitations that should be acknowledged. First, the reliance on aggregate data may obscure important heterogeneity across different types of institutions, markets, and geographic regions. Disaggregated analysis could reveal patterns not captured in the aggregate measures employed here. Second, the study period, while covering significant events, may not be representative of longer-term trends or capture the full range of conditions the financial system might face.

Third, the analysis of causal relationships between monetary policy and market outcomes is complicated by potential endogeneity and omitted variable bias. While the correlations documented are consistent with theoretical predictions, establishing strict causality would require more sophisticated identification strategies. Fourth, qualitative assessments of regulatory frameworks and institutional mechanisms are inherently subjective and may not capture the full complexity of these phenomena.

5. CONCLUSION

The article provides an unprecedented empirical examination of the structure, performance, and macroeconomic function of the American financial system over the period 2015–2024. According to results, the U.S. continues to have the largest and most sophisticated financial system in the world, with total financial assets above 130 trillion dollars. While continuing its evolution the financial intermediation spread share of non bank financial institutions relative to the traditional commercial banks.

Despite marked volatility, equity markets were stable over the long term. The S and P 500 index more than doubled over the study period, as a result of both economic expansion and generous financial conditions. Monetary policy became one of the key determinants of financial results, with interest rate and balance sheet policies having a significant impact on markets. Banking system remained generally sound with adequate capital and liquidity buffers, although some pervasive structural vulnerabilities still exist.

The paper makes several important contributions to the literature. It first updates facts on the size, composition, and performance of the US financial system with an empirical overview that includes more recent shocks (in particular the COVID 19 pandemic and the underlying policy responses). Second, it provides a record of the impact of non-traditional monetary policy instruments in a period of extreme economic stress. Third, the study presents a more integrated perspective on financial system dynamics by integrating quantitative financial analysis with qualitative consideration of regulatory and institutional factors. Fourth, it identifies contexts in which extant theory may need to be updated to accommodate continuing changes in the structure of financial intermediation.

The review further highlights areas for future research: finer categorization of different types of financial sector activities; larger time series contours to disentangle cyclical versus structural trends; in-depth analysis of fintech; and cross-country examples. Ongoing study of these topics is critical for both the maintenance of financial stability and the provision of long-run growth.

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