MONEY MARKET

Money Market

- ❑ Meaning role and functions
- ❑ Structure of a money market
- ❑ Structure of Indian money market
- ❑ Segments and instruments
- ❑ Unorganised sector of Indian money market
- ❑ Limitations of Indian money market
- ❑ Reforms of Indian money market

Money Market

Meaning

- The money market is a market for lending and borrowing of short-term funds.
- It deals with funds and financial instruments having a maturity of 1 day to 1 year.
- The instrument in the money market are of short-term nature and highly liquid.
- It is a liquid and can be converted into cash without loss of time and value.
- Money market defined as

"an organized mechanism for effective and smooth transfer of money capital or financial instruments".

Money Market

Role and functions of money market

- It provides a mechanism to achieve **equilibrium between demand for and supply** of short term funds.

- It helps the **RBI in effective implementation of monetary policy**.

- It provides **ample avenues for investment of short term** funds with fair returns.

- It provides fund to user to meet the short term needs at a fair prices.

- It helps in allocation **of short term funds through inter bank transactions and money market instruments.**

- It also **provides funds in non inflationary way** to the government to meet its deficits.

Money Market

Structure of Money Market

1. Institutions

- The government, central bank of the country, commercial banks, cooperative banks, other financial institution, business corporates and primary dealers are the important institutions for players in the money market.

2. Instruments

- Lending and borrowing are carried out with the help of money market instruments.

3. Market segments

- call money market, treasury bill market, commercial bill markets, CDs market, CPS market
- each market has its own specific market an instruments
- specific norms applicable to them.

Important players and their roles

1.RBI

- Money market comes with the direct purview of RBI regulation.
- The objective of RBI operation in the money market is to ensure that liquidity and short-term interest rate maintained
- The primary objectives of monetary policy are to ensure economic growth and price stability.
- RBI also does the role of merchant banker to the government.

2. Government

- Government is an active money market player and it, in most economics, is the biggest borrower in the money market.
- The government needs to borrow funds when the budget and expenditure is larger than the budget revenues.
- Thurs government is the borrower in the money market.

3. Banks

- They are very important money market players.
- Banks undertake lending and borrowing of short-term funds.
- The collective operations of the banks on the day-to-day basis are very prominent
- Banks have a major impact on the interest rate structure of the liquidity position.

4. **Financial institutions**

- These institution undertake lending and borrowing of short-term funds.
- They transact in large volumes and hence have a significant impact on a money market.

5. **Business corporates**

- They transact to raise short term fund for meeting their working capital requirement.

6. **Non-bank financial intermediaries**

- Consists of mutual funds foreign institutional investors e
- They accept deposit in various form and land or invest in different economic activities.

7. **Discount and finance house of India DFHI**

- The role of DFHI is both developmental and stabilizing.
- It was accredited as a primary dealer PD in February 1996.

8. **Primary dealers PD**

- Were introduced in 1995 by RBI to develop an active secondary market for government securities
- They also act as a underwriter to the government securities.

Segments and instruments

Indian money market has several segment submarket each one using a different instruments.

Sub Markets	: **Instruments**
Call Money Market	: Call Money
Treasury Bill Market (T Bills)	: Treasury Bills (T Bills)
Commercial Bill Market	: Commercial Bills
Certificates of Deposit (CDs) Market	: Certificate of Deposits (CDs)
Commercial Papers (CPs) Market	: Commercial Papers (CPs)
Repo Market	: Repo (Government Securities)
Liquidity Adjustment Facility (LAF)	: Government Securities
Marginal Standing Facility (MSF)	: Government Securities
Mutual Funds Market	: Mutual Fund Units

Call money market

- The call / notice money market forms an important segment of Indian money market.
- Under call money market, funds are transacted on overnight basis.
- Under notice, money market is transacted for the period between **2 days to 14 days.**
- On receipt of this notice the borrower will have to repay the fund within the given time.
- Mostly bank does the trading.
- The daily average turnover ranges between Rs 150000 to Rs 20000 crores in this market

Treasury bills (t-bills)

- Treasury bills are short term security issued by RBI on behalf of government of India. **(Zero coupon bond)**

- They are the main instrument of short-term borrowing by the government.
- They are useful in managing short term liquidity.
- **At present, the government of India issues 3 types of treasury bills**

91 days,

182 days,

and 365 days treasury bills.

Treasury bills (t-bills)

➢ **Important features of t bills are**

- Highly liquid
- Absence of risk of default
- Ready availability
- Assured yield
- No transaction cost
- **t - bills are now available from a minimum amount of 25000 and multiples of 25,000.**
- T bills are tradable in the secondary market which is quite active.

Participants in t - Bill market are **commercial banks, primary dealers, mutual funds, corporate, financial institution, provident fund, pension funds and insurance companies.**

Commercial bills

- Commercial bill is a short-term, negotiable, and self-liquidating instrument with low risk.
- They are negotiable instrument drawn by a seller on the buyer for the value of goods delivered by him.
- Such bills are called **trade bills**.
- **When trade bills are accepted by commercial banks**, they are called commercial bills.
- If the seller give some time for payment, the bill is payable in future date that is **(usance bill).**
- The commercial bill market in India is underdeveloped.
- Lack of uniformity and high stamp duty have been responsible factors for uneven growth

Certificate of deposits CDs

- CDs are unsecured, negotiable promissory notes issued at a discount to the face value
- They are issued by commercial banks and development financial institutions.
- CDs are marketable receipts of funds deposited in a bank for a fixed period at a specific rate of interest.
- The fixed tenure ranges from 7 days to 5 years
- Thurs, CDs are highly liquid and risk less money market instruments.
- CDs were introduced in India in June 1989.

Commercial papers (CPs)

- Commercial paper is an **unsecured money market instrument (big corporate house)**
- ~~**Its** issued in the form of a promissory note with fixed maturity. (Bridge Financing)~~
- The issue promises a fixed amount at a future date but pledges no assets.
- CPs were introduced in India in January 1990.

Repos

- The major function is to provide liquidity.
- The Repo rate is the interest rate at which RBI lends short term funds to commercial banks
- When banks fall short of cash they borrow by pledging government securities
- Repo was introduced in December 1992.
- Reverse repo was introduced in December 1996.

Liquidity adjustment facility (LAF)

- It was introduced by RBI in June 2000.
- It is a monetary policy tool which allows banks to borrow money from the RBI through repurchase agreements.
- LAF is used to add banks in adjusting the day-to-day mismatches in liquidity.

Marginal standing facility (MSF)

- RBI introduced marginal standing facility in its monetary policy on 3rd May 2011.
- It has become effective from 9th May 2011.
- Prior to this facility banks were allowed to borrow overnight at their discretion, up to 2% of their respective net demand and time liabilities (NDTL) at 100 base.
- That is 1% above the repo rate

Money market mutual funds (MMMFs)

- RBI introduce MMMFs in **April 1992** to enable small investor to participate in the money market.
- It mobilize saving from small investors and
- Assist them to invest them in short term debt instrument of money market instruments

  such as in call money, propose treasury bills, CDs, CPS.

Unorganized sector of Indian money market

- The unorganized Indian money market is made up of

  indigenous bankers, moneylenders and unregulated non bank financial intermediaries.

Main components of Unorganised Money Market

1. Indigenous bankers

- They are financial intermediaries which operate as banks, receive deposits and give loans and deal in hundies.
- The hundi is a short-term credit instrument.
- It is the indigenous bill of exchange.
- The rate of interest differs from one market to another and from one bank to another.
- They are known as kathawals, sarafs, shroffs or chettis.

2. Money lenders

- They are those who primary business is money lending.
- Money lenders are predominant in **villages.**
- **Interest rates are generally high.**
- Large amount of loans are given for **productive purpose**.
- The borrowers are generally **agricultural laborer's, marginal and small farmers, artisans, factory workers, small traders, etc.**

3. Unregulated non-bank financial intermediaries

a. Chit funds

b. Nidhi's

c. Loan companies

d. Finance brokers

Limitations of the Indian money market

1. Existence of Dichotomy dualism
2. Lack of integration
3. Multiplicity of interest rates
4. Inadequate funds
5. Seasonal stringency of money
6. Absence of well-organized Bill market
7. Inadequate credit instruments.

Reforms under the Indian Money Market

- The Committee to review the working of Monetary System was chaired by **S. Chakravarty**
- Committee made several recommendations in 1985 to develop Indian money market.
- As a follow-up, the RBI set up a Working Group on money market under the **chairmanship of N. Vaghul in 1987.**
- Based on the recommendations of the **Vaghul Committee,**

  RBI has initiated a number of measures to widen and deepen the money market.

Reforms introduced under Indian Money Market

- Deregulation of interest rates
- Introduction of new money market instruments
- Repurchase agreement repos
- Liquidity adjustment facility
- Marginal standing facility
- Money market mutual fun discount and finance house of India
- Regulation of NBFC’s
- The clearing corporation of India limited CCIL