




Money Market

Unit 1


- ▶ Financial markets are the centres that provide facilities for buying and selling of financial assets.
 - ▶ An important function of financial market is to transfer funds from lenders to borrowers.
 - ▶ Financial markets includes buyers and sellers of securities and institutions which help in the buying and selling of securities issued by corporates and government.
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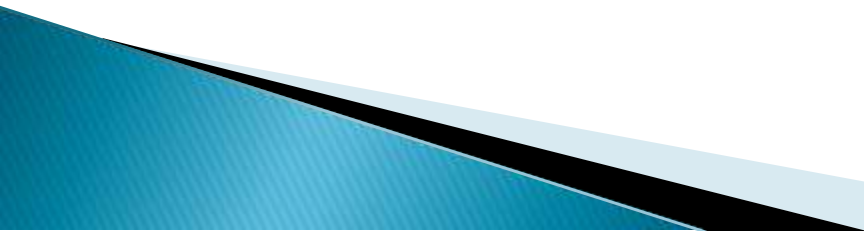
- ▶ Financial markets are classified into 2 broad categories.
 - ▶ Capital Market
 - ▶ Money Market
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Capital Market

- ▶ It is the market that specializes in trading long term and relatively high risk securities.
 - ▶ It is a place where buyers and sellers of securities can enter into transactions to purchase and sell shares, bonds and debentures.
 - ▶ Capital market provides long term debt and equity finance for the government and the corporate sector.
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Money Market

- ▶ Financial Market for short term financial assets is called Money Market.
 - ▶ Money Market is a mechanism that deals with the lending and borrowing of short term funds.
 - ▶ It is a centre in which financial institutions join together for the purpose of dealing in financial or monetary assets, which are of short term maturity.
 - ▶ Money market is a market for short term financial assets that are close substitute of money.
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- ▶ Close substitute of money denotes any financial asset, which can be quickly converted into money with the minimum transaction cost and without a loss.
 - ▶ In short money market is a market where money is bought and sold.
 - ▶ The short term debt and securities sold in the money market are also known as Money market instruments and have a maturity ranging from one day to one year and are extremely liquid.
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- ▶ Money market is important for businesses because it allows companies with a temporary cash surplus to invest in short term securities.
 - ▶ It also allows companies with temporary short fall to sell securities or borrow funds on a short term basis.
 - ▶ A well functioning money market provides a relatively safe and steady income yielding avenue for short term investment of funds for both banks and corporates and allows the investor institutions to optimize the yield from temporary surplus funds.
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Definitions

- ▶ **Crowther**, "The money market is a name given to the various firms and institutions that deal in the various grades of near money."
 - ▶ RBI describes money market as "the centre for dealings, mainly of a short-term character, in monetary assets, it meets the short-term requirements of borrowers and provides liquidity or cash to lenders".
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Features of Money Market


- ▶ Money market deals with securities which are highly liquid.
- ▶ It deals with securities which are readily transferable.
- ▶ It specializes in very short term debt securities.
- ▶ Most of the transactions in money market have a maturity period of overnight to one week.
- ▶ It is a heterogeneous market with several sub markets. Each sub market deals with specific short term credit instruments.
- ▶ It is wholesale market.
- ▶ The role of individuals in money market is not significant.

- ▶ Money market does not refer to any specific place where borrowers and lenders meet each other.
 - ▶ Borrowing and lending in money market is in high volume.
 - ▶ Due to high volumes, transaction cost is high.
 - ▶ Money Market securities offer lower rate of returns than most other securities.
 - ▶ The risk of investment is very low.
 - ▶ Money market is a dealers market i.e. securities are bought and sold in their own account.
 - ▶ Securities in money market are of high face value.
 - ▶ Money market is regulated by RBI.
 - ▶ Money Markets are generally associated with important places. In India it is located in major cities like Delhi, Mumbai, Chennai, Kolkata etc.
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Importance of Money Market



1. Development of Trade & Industry
 2. Development of Capital Market
 3. Smooth Functioning of the Commercial Banks
 4. Effective Bank Control
 5. Formulation of suitable Monetary Policy
 6. Source of finance to the Government
 7. Effective monetary transmission
 8. Role of Primary Dealers in Money Market
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Development of Trade & Industry

- ▶ Trade and Industry are the key factors which lead to the economic development of a country. They ensure production of goods, availability of services, generation of employment to the human resources, earnings in foreign currencies among various advantages to the financial system.
- ▶ At such a time money market plays a crucial role of making Liquidity available at the requisite time to the corporate for the smooth conduct of the business.
- ▶ Trade financing as well as working capital requirements of the business are duly met of through money market. Thereby the money market facilities both the trade and the industry ultimately resulting in the development of the country.

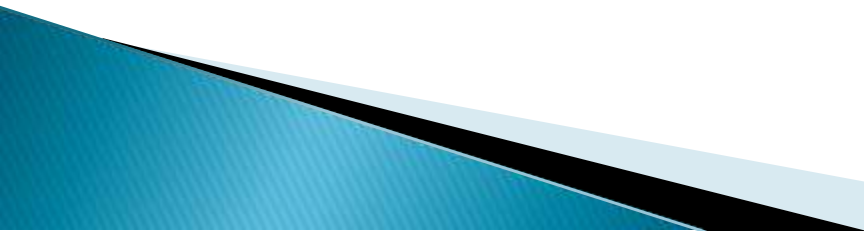
Development of Capital Market

- ▶ The money market rates provides an opportunity to the RBI to influence the volume and the cost of liquidity on a short term basis.
- ▶ Changes in the short term policy rate provide signals to financial markets, whereby different segments of the financial system respond by adjusting their rates of return on various instruments. This in turn affects the long term interest rates as well as pattern of financing for the business.
- ▶ This may require firms to change their proportion of debt or equity depending on the financing cost i.e. the cost of capital. Thus leading to the development of the capital market.

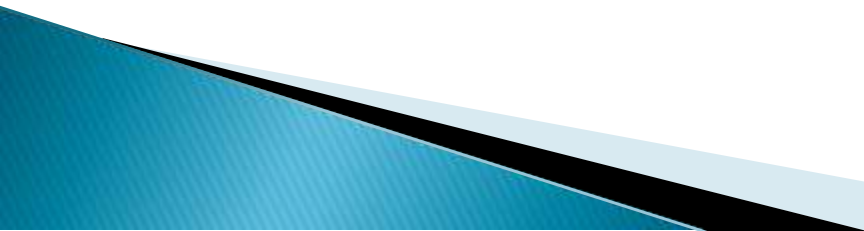
Smooth Functioning of the Commercial Banks

- ▶ Since the RBI frames and updates the monetary policy on a regular basis, the commercial banks need to adjust their credit policies accordingly.
- ▶ This phenomenon results with the banks having temporary surpluses.
- ▶ The money market in such a situation provides the commercial banks an opportunity to effectively utilize such funds.
- ▶ Also it becomes convenient for the banks to maintain the CRR and SLR.


Effective Bank Control

- ▶ The monetary policy is set by the RBI at suitable intervals based on the economic conditions.
 - ▶ An effective policy helps in maintaining adequate money supply by pumping in funds into the economy during a down swing or resorting to OMO to curb the money flow to promote the economic growth of the country.
 - ▶ This is done by limiting the money market instruments participation in the economy.
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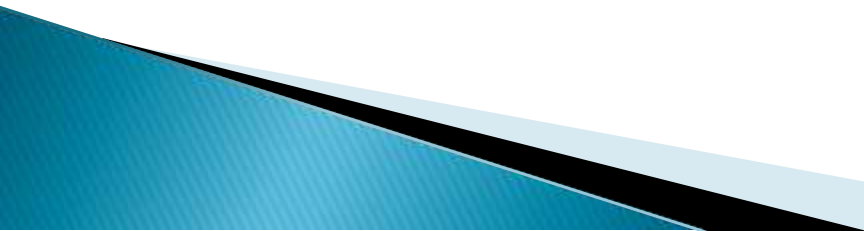
Formulation of suitable Monetary Policy

- ▶ Monetary policy is the adjustment of the supply of money in the economy to achieve some combination of inflation and output stabilization.
 - ▶ The money market indicates to the central bank and the government, the true state of the economy thru the prevailing short term interest rates.
 - ▶ Based on these inputs a suitable and sufficient monetary policy is then framed by the RBI.
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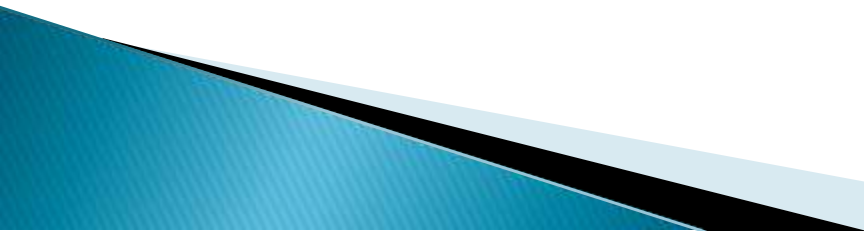
Source of finance to the government

- ▶ The government both, state and the central thru the RBI issue treasury bills having varied maturities of 91 days, 182 days and 364 days to raise and redeem funds for funding various activities of the government.
 - ▶ Also in consultation with the RBI the government issues Cash Management Bills to meet the temporary mismatches in the cash flow of the government.
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Ensuring Effective Monetary transmission

- ▶ Controlling and regulating the money supply of the economy is monetary transmission.
 - ▶ RBI thru monetary policy may change the interest rates which have an intriguing effect on the economy.
 - ▶ The liquidity conditions can be managed consistently thru monetary policy, its objectives is to ensure proper fund allocation and transfers.
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Role of Primary Dealers in Money Market

- ▶ PD's are registered entities with the RBI who have a license to purchase and sell government securities.
 - ▶ They are entities who buy government securities directly from RBI aiming to resell them to other buyers.
 - ▶ In this way, the Primary Dealers create a market for government securities.
 - ▶ They formed in India to act as a catalyst to develop active market for G securities.
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Thank You