UNIT II

FINANCIAL MARKETS -I

6 CHAPTER

MONEY MARKET

சிறப்புஈனும் செல்வமும் ஈனும் அறத்தினூஉங்கு
ஆக்கம் எவனோ உயிர்க்கு.

–குறள் 31

COUPLET

Virtue will confer heaven and wealth; what greater source of happiness can man possess ?

Learning Objectives

To enable the students to understand the

- Characteristics of Money Market
- The Difference between Capital Market and Money Market
- The Money Market Instruments

Chapter Synopsis

Money Market

Money Market is a market for purely short-term funds. It deals with the financial assets and securities whose maturity period does not exceed one year.

6.01 Meaning and Definition

Money Market is the segment of financial markets where in financial instruments having maturities of less than one year are traded. Examples: Treasury Bills, Commercial Bills, Certificate of Deposits, Government Securities, etc.,

According to Crowther, "the money market is the collective name given to the various firms and institutions that deal in the various grades of near money".

The RBI defines the money market as, "a market for short-term financial assets that are close substitutes for money facilitates the exchange of money for new financial claims in the primary market as also for financial claims, already issued, in the secondary market".

6.02 Objectives and Characteristics

Objectives

A well-developed Money Market serves the following objectives:

1. Providing an equilibrium mechanism for ironing out short-term surplus and deficits.
2. Providing a focal point for Central Bank intervention for influencing liquidity in the company.
3. Providing access in uses to users of short-term money to meet their requirements at a reasonable price.

Characteristics

1. Short-term Funds

It is a market purely for short-term funds or financial assets called near money.

2. Maturity Period

It deals with financial assets having a maturity period upto one year only.

3. Conversion of Cash

It deals with only those assets which can be converted into cash readily without loss and with minimum transaction cost.

4. No Formal Place

Generally, transactions take place through phone, i.e., oral communication. Relevant documents and written communications can be exchanged subsequently. There is no formal place like stock exchange as in the case of a capital market.

5. Sub-markets

It is not a single homogeneous market. It comprises of several sub-markets each specialising in a particular type of financing. E.g., Call Money Market, Acceptance Market, Bill Market.

6. Role of Market

The components of a money market are the Central Bank, Commercial Banks, Non-Banking Financial Companies, Discount Houses and Acceptance House. Commercial banks generally play a dominant role in this market.

7. Highly Organized Banking System

The Commercial Banks are the nerve centre of the whole money market. They are the principal suppliers of short-term funds. The commercial banks serve as vital link between the Central Bank and the various segments of the money market.

8. Existence of Secondary Market

There should be an active secondary market for these instruments.

9. Demand and Supply of Funds

There should be a large demand and supply of short-term funds. It presupposes the existence of a large domestic and foreign trade.

10. Wholesale Market

It is a wholesale market and the volume of funds or financial assets traded in the market is very large.

11. Flexibility

Due to greater flexibility in the regulatory framework, there are constant endeavours for introducing new instruments.

12. Presence of a Central Bank

The central bank keeps their cash reserves and provides them financial accommodation in difficulties by discounting their eligible securities. Through its open market operations the central bank absorbs surplus cash during off-seasons and provides additional liquidity in the busy seasons.

6.03 Money Market vs. Capital Market

The difference between a money market and capital market is briefly stated in the following table.

Sl. No	Features	Money Market	Capital Market
1	**Duration of Funds**	It is a market for short-term loanable funds for a period of not exceeding one year.	It is a market for long-term funds exceeding period of one year.
2	**Supply of Funds**	This market supplies funds for financing current business operations working capital requirements of industries and short period requirements of the government.	This market supplies funds for financing the fixed capital requirements of trade and commerce as well as the long-term requirements of the government.
3	**Deals with Instruments**	It deals with instruments like commercial bills (bill of exchange, treasury bill, commercial papers etc.).	It deals with instruments like shares, debentures, Government bonds, etc.,
4	**Money Value**	Each single money market instrument is of large amount. A treasury bill is of minimum for ₹25000. Each certificate of deposits or commercial paper is for minimum of ₹5 lakhs.	Each single capital market instrument is of small amount. Each share value is ₹10. Each debenture value is ₹100.
5	**Role of Major Institution**	The central bank and commercial banks are the major institutions in the money market.	Development banks and Insurance companies play a dominant role in the capital market.
6	**Place of Transaction**	Transactions mostly take place over the phone and there is no formal place.	Transactions take place at a formal place. Eg. stock exchange.
7	**Participants**	Transactions have to be conducted without the help of brokers i.e., Bankers, RBI and Government.	Transactions have to be conducted only through authorized dealers i.e., Brokers, Investors, Merchant Bankers, Underwriters and Commercial Banks.
8	**Number of Instruments Dealt**	The number of instruments dealt in money market are include 1) Inter-bank call money 2) Notice money upto 14 days 3) Short-term deposits upto 3months 4) 91 days Treasury bill 5) 182 days Treasury bill 6) Commercial papers etc.,	The number of instruments in capital market is very few namely, shares and debentures.

9	**Claims**	Financial claims, assets and securities are dealt in the Money Market.	Bonds and shares are dealt in the Capital Market
10	**Risk**	Low credit and market risk.	High credit and market risk
11	**Liquidity**	High liquidity in Money Market	Low liquidity in Capital Market
12	**Price Discovery**	No price discovery mechanism and exists in this Market.	Price discovery mechanism exists in Capital Market
13	**Regulator**	Central Bank is the Regulator of Money Market.	Besides Central Bank, Special regulatory authority like SEBI, etc.,
14	**Underwriting**	Underwriting is not a primary function.	It is a primary function.
15	**Dominant Institutions**	Commercial Banks are the dominant institutions.	Non-banking financial companies and special financial institutions.

6.04 Participants in Money Markets

There are many participants operating in the Money Market. The participants deal with the money market instruments like Treasury Bills, Commercial Bills, Commercial Papers, etc.,

1. Government of different countries
2. Central Banks of different countries
3. Private and Public Banks
4. Mutual Funds Institutions
5. Insurance Companies
6. Non-Banking Financial Institutions
7. RBI and SBI
8. Commercial Banks
9. State Governments
10. Public

6.05 Money Market Instruments

There are many kinds of Instruments available in Money Market. In India, till 1986, only a few instruments were available. They were as follows:

i. Treasury Bills in the Treasury Market
ii. Money at Call and Short Notice in the Call Loan Market
iii. Commercial Bills and Promissory Notes in the Bill Market

Now in addition to the above, the following new instruments come into existence:

i. Commercial Papers
ii. Certificate of Deposits
iii. Inter-Bank participation Certificates.
iv. Repo Instruments.

These instruments are brieflty highlighted in this chapter.

Treasury Bill Market

A market for the purchase and sale of Treasury Bills is known as a "Treasury Bills Market".

6.05.01 Treasury Bills

Treasury bills are very popular and enjoy a higher degree of liquidity since they are issued by the Government. A Treasury bill is nothing but a promissory note issued for a specified period stated therein. The Government promises to pay the specified amount mentioned therein to the bearer of the instrument on the due date. The period does not exceed a period of one year.

General Features

Treasury Bills incorporate the following general features.

1. Issuer
2. Finance Bills
3. Liquidity
4. Vital Source
5. Monetary Management

Types of Treasury Bills

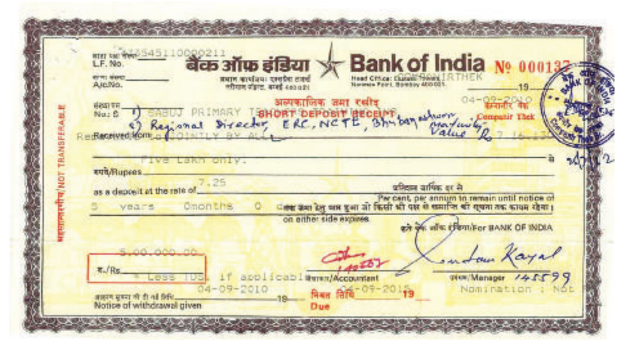
Treasury Bills are issued to the public and other financial institutions for meeting the short-term financial requirements of the Central Government. These bills are freely marketable and they can be bought and sold at any time and these bill are tradable in secondary market as well.

On the basis of periodicity, Treasury Bills may be classified into three. They are:

1) 91 days Treasury Bills
2) 182 days Treasury Bills and
3) 364 days Treasury Bills

Ninety one days Treasury Bills are issued at a fixed discount rate of 4 per cent as well as through auctions. The RBI holds 91 days and 182 Treasury Bills and they are issued on tap basis throughout the week. 364 days Treasury Bills do not carry any fixed rate. The discount rate on these bills are quoted in auction by the participants and accepted by the authorities. Such a rate is called cut off rate.

6.05.02 Certificate of Deposits



Specimen Copy of Certificate of Deposit

Certificate of Deposits are short-term deposit instruments issued by banks and financial institutions to raise large sums of money. Certificate of Deposits are issued in the form of usance promissory notes. They are easily convertible in nature and are in marketable form having particular face value and maturity. The Certificate of Deposit is transferable from one party to another. Due to their negotiable feature, they are also known as negotiable certificate of deposit.

Issuers

The Issuers of Certificate of Deposits are Commercial Banks, Financial Institutions, etc.,

Subscribers

Certificate of Deposits are available for subscription by individuals, corporations, trusts, associations and NRIs. It is a document of title to a time deposit. It is a bearer certificate and is negotiable in the market.

Features of Certificate of Deposit

1. Document of title to time deposit
2. It is unsecured negotiable instruments.
3. It is freely transferable by endorsement and delivery.
4. It is issued at discount to face value.
5. It is repayable on a fixed date without grace days.

6.05.03 Commercial Bills

A bill of exchange issued by a commercial organization to raise money for short- term needs. These bills are of 30 days, 60 days and 90 days maturity.

The Commercial Bill is an instrument drawn by a seller of goods on a buyer of goods. It possesses the advantages like self-liquidating in nature, recourse to two parties, knowing exact date of transactions, transparency of transactions etc.,

Features

The features of the Commercial Bills are as follows:

1. Drawer
2. Acceptor
3. Payee
4. Discounter
5. Endorser
6. Assessment
7. Maturity
8. Credit Rating

Types of Commercial Bills

a. Demand Bills

A demand bill is one wherein no specific time of payment is mentioned. So, demand bills are payable immediately when they are presented to the drawee.

b. Clean bills and documentary Bills

Bills that are accompanied by documents of title to goods are called documentary bills. Clean bills are drawn without accompanying any document.

E.g. Railway Receipt and Lorry Receipt

c. Inland bills and Foreign Bills

Bills that are drawn and payable in India on a person who is resident in India are called inland bills. Bills that are drawn outside India and are payable either in India or outside India are called foreign bills.

d. Indigeneous Bills

The drawing and acceptance of indigenous bills are governed by native custom or usage of trade.

e. Accommodation Bills

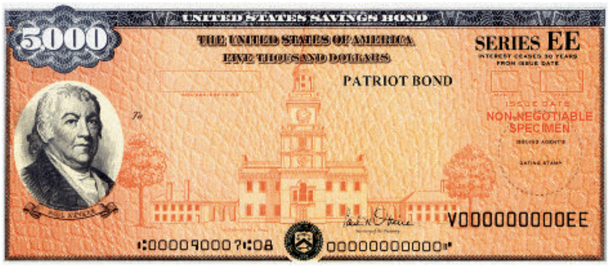
Accommodation bills are those which do not arise out of genuine trade of transactions.

6.05.04 Government or Gilt-Edged Securities Market

A market whereby the Government or gilt-edged securities can be bought and sold is called 'Government Securities Market'.

Government or Gilt-Edged Securities

Government securities are issued for the purposes of refunding the maturing securities, for advance refunding securities, which have not yet matured and for cash financing, i.e., raising fresh cash resources.



Specimen Copy of Government or Gilt-Edged Securities

Characteristics

Government Securities plays a significant role in the Indian Money Market. The characteristics of Government Securities are discussed below:

1. Agencies

Government securities are issued by agencies such as Central Government, State Governments, semi-government authorities like local Government authorities, e.g. municipalities, autonomous institution such as metropolitan authorities, port trusts etc.,

2. RBI Special Role

RBI takes a special and an active role in the purchase and sale of these securities as part of its monetary management exercise.

3. Nature of Securities

Securities offer a safe avenue of investment through guaranteed payment of interest and repayment of principal by the Government.

4. Liquidity Profile

The liquidity profile of gilt-edged securities varies. Accordingly liquidity profile of securities issued by Central Government is high.

5. Tax Rebate

A striking feature of these securities is that they offer wide-range of tax incentives to investors. This has made these securities very popular for this benefit.

6. Market

As each sale and purchase has to be negotiated separately, the Gilt-Edged Market is an Over-The-Counter Market. The Government securities market in India has two segments namely primary market and secondary market.

7. Forms

The securities of Central and State Government take such forms as inscribed stock or stock certificate, promissory note and bearer bond.

8. Participants

The participants in Government securities market include the Government sector comprising Central and State Governments whose holdings represent governmental transfer of resources.

9. Trading

Although the secondary market for Government securities is narrow, small and less active, banks and corporate holders who purchase and sell Government securities on the stock exchanges participate in trading.

10. Issue Mechanism

The Public Debt Office (PDO) of the RBI undertakes to issue government securities.

11. Issue opening

A notification for the issue of the securities is made a few days before the public subscription is open.

12. Grooming Gradual

Acquisition of securities nearing maturity through the stock exchanges by the RBI in order to facilitate redemption is described as 'grooming'.

13. Switching

The purchase of one security against the sale of another security carried out by the RBI in the secondary market as part of its open market operations is described as 'Switching'.

14. Auctioning

A method of trading whereby merchants bid against one another and where the securities are sold to the highest bidder is known as 'auctioning'.

Key Words

Treasury Bills	Commercial Bills
Commercial Papers	Government Bonds
Money Market	Capital Markets
Certificate of Deposits	Auctioning

London Money Market is the oldest, most developed and leading Money Market in the world.

New York Money Market is ranked as the second well-developed Money Market in the world next only to the London Money Market.

For Future Learning

How to Invest Money in Money Market Funds?

Gathering information about Money Market Funds

Learn about money market

Understand the goal of money market funds.

Learn the disadvantages of money market funds.

Investing in Money Market Funds

Understand the different types of Money Market Funds

Understand the purpose of Money Market Funds

Compare past yields

Buying and Tracking of Money Market Funds

For Own Thinking

If you earn money, which investment plan would you like?

1. Mutual Funds
2. Shares
3. Debentures
4. Treasury Bill
5. Commercial Bill
6. Certificate of Deposit

Why? Give reasons.

Exercise

I. Choose the Correct Answers:

1. The money invested in the call money market provides high liquidity with ________________.

a) Low Profitability

b) High Profitability

c) Limited Profitability

d) Medium Profitability

2. A major player in the money market is the ________________.

a) Commercial Bank

b) Reserve Bank of India

c) State Bank of India

d) Central Bank.

3. Debt Instruments are issued by Corporate Houses are raising short-term financial resources from the money market are called __________.

a) Treasury Bills

b) Commercial Paper

c) Certificate of Deposit

d) Government Securities

4. The market for buying and selling of Commercial Bills of Exchange is known as a __________.

a) Commercial Paper Market

b) Treasury Bill Market

c) Commercial Bill Market

d) Capital Market

5. A marketable document of title to a time deposit for a specified period may be referred to as a ___________.

a) Treasury Bill

b) Certificate of Deposit

c) Commercial Bill

d) Government. Securities

Answers:

1	a	2	a	3	b	4	c	5	b

II. Very Short Answer Questions:

1. What is a CD market?
2. What is Government Securities Market?
3. What do you meant by Auctioning?
4. What do you meant by Switching?

III. Short Answer Questions:

1. What are the features of Treasury Bills? (any 3)
2. Who are the participants of Money Market? (any 3)
3. Explain the types of Treasury Bills? (any 3)
4. What are the types of Commercial Bill? (any 3)

IV. Long Answer Questions:

1. Differenciate between the Money Market and Capital Market. (any 5)
2. Explain the characteristics of Money Market? (any 5)
3. What are the characteristics of Government Securities? (any 5)

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1. Financial Markets and Services – E.Gordon and Natarajan,
2. Investment Management Security Analysis and Portfolio Management – Dr. L Natarajan,
3. Financial Services (Indian Financial System) – Prof. B. Santhanam, Financial Marketing – Dr. Gurusamy