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Chapter – 2

MONEY MARKET

Financial Market deals in financial instruments (securities) and financial services. Financial markets are classified into two, namely, money market and capital market**.**

Meaning of Money Market

Money market is a segment of financial market. It is a market for short term funds. It deals with all transactions in short term securities. These transactions have a maturity period of one year or less. Examples are bills of exchange, treasury bills etc. These short term instruments can be converted into money at low transaction cost and without much loss. Thus, money market is a market for short term financial securities that are equal to money.

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

Money market is not a place. It is an activity. It includes all organizations and institutions that deal in short term financial instruments. However, sometimes geographical names are given to the money market according to the location, e.g. Mumbai Money Market.

Characteristics of Money Market

The following are the characteristics of money market:

1. It is a market for short term financial assets that are close substitutes of money.
2. It is basically an over the phone market.
3. It is a wholesale market for short term debt instruments.
4. It is not a single market but a collection of markets for several instruments.
5. It facilitates effective implementation of monetary policy of a central bank of

a country.

6. Transactions are made without the help of brokers.
7. It establishes the link between the RBI and banks.
8. The players in the money market are RBI, commercial banks, and companies.

Functions of Money Market

Money market performs the following functions:

1. Facilitating adjustment of liquidity position of commercial banks, business undertakings and other non-banking financial institutions.
2. Enabling the central bank to influence and regulate liquidity in the economy through its intervention in the market.
3. Providing a reasonable access to users of short term funds to meet their requirements quickly at reasonable costs.
4. Providing short term funds to govt. institutions.
5. Enabling businessmen to invest their temporary surplus funds for short period.
6. Facilitating flow of funds to the most important uses.
7. Serving as a coordinator between borrowers and lender of short term funds.
8. Helping in promoting liquidity and safety of financial assets.

Thus, a well developed money market is essential for economic growth and stability.

Components / Constituents / Composition of Money Market (Structure of Money Market)

Money market consists of a number of sub markets. All submarkets collectively constitute the money market. Each sub market deals in a particular financial instrument. The main components or constituents or sub markets of money markets are as follows:

1. Call money market
2. Commercial bill market
3. Treasury bill markets
4. Certificates of deposits market
5. Commercial paper market
6. Acceptance market
7. Collateral loan market

I. Call Money Market

Call money is required mostly by banks. Commercial banks borrow money without collateral from other banks to maintain a minimum cash balance known as cash reserve ratio (CRR). This interbank borrowing has led to the development of the call money market.

Call money market is the market for very short period loans. If money is lent for a day, it is called call money. If money is lent for a period of more than one day and upto 14 days is called *short notice money*. Thus call money market refers to a market where the maturity of loans varies between 1 day to 14 days. In the call money market, surplus funds of financial institutions, and banks are traded. There is no demand for collateral security against call money.

In India call money markets are mainly located in big industrial and commercial centres like Mumbai, Kolkata, Chennai, Delhi and Ahmadabad.

Participants or Players in the Call Money Market

1. Scheduled commercial banks and RBI
2. Non-Scheduled commercial banks
3. Co-operative banks
4. Foreign banks
5. Discount and Finance House of India
6. Primary dealers

   The above players are permitted to operate both as lenders and borrowers.

(1) LIC (2) UTI (3) GIC (4) IDBI (5) NABARD (6) Specific mutual funds,

etc. The above participants are permitted to operate as lenders

2. Commercial Bill Market

Commercial bill market is another segment of money market. It is a market in which commercial bills (short term) are bought and sold. Commercial bills are important instruments. They are widely used in both domestic and foreign trade to discharge the business obligations (or to settle business obligations). Discounting is the main process in this market. Hence commercial bill market is also known as *discount market*.

There are specialized institutions known as discount houses for discounting commercial bills accepted by reputed acceptance houses. RBI has permitted the financial institutions, mutual funds, commercial banks and co- operative banks to enter in the commercial bill market.

3. Treasury Bills Market

Treasury bill market is a market which deals in treasury bills. In this market, treasury bills are bought and sold. Treasury bill is an important instrument of short term borrowing by the Govt. These are the promissory notes or a kind of finance bill issued by the Govt. for a fixed period not extending beyond one year. Treasury bill is used by the Govt. to raise short term funds for meeting temporary Govt. deficits. Thus it represents short term borrowings of the Govt.

Advantages or Importance of Treasure Bill

Market Advantages to the Issuer / Govt.

1. The Govt. can raise short term funds for meeting temporary budget deficit.
2. The Govt. can absorb excess liquidity in the economy through the issue of T- bills in the market.
3. It does not lead to inflationary

pressure. Advantages for the

Purchaser/ Investor

1. It is a ready market for purchasers or investors.
2. It is a safety instrument to invest.

3. Treasury bills are eligible securities for SLR requirement.
4. The market provides hedging facility.

4. Certificates of Deposits Market

CD market is a market which deals in CDs. CDs are short term deposit instruments to raise large sums of money. These are short term deposits which are transferable from one party to another. Banks and financial institutions are major issuers of CD. These are short term negotiable instruments.

Advantages of CD Market

1. It enables the depositors to earn higher return on their short term surplus.
2. The market provides maximum liquidity.
3. The bank can raise money in times of need. This will improve their lending capacity.
4. The market provides an opportunity for banks to invest surplus funds.
5. The transaction cost of CDs is lower.

5. Commercial Paper Market

Commercial Paper Market is another segment of money market. It is a market which deals in commercial papers. Commercial papers are unsecured short term promissory notes issued by reputed, well established and big companies having high credit rating. These are issued at a discount. Commercial papers can now be issued by primary dealers and all India financial institutions. They can be issued to (or purchased by) individuals, banks, companies and other registered Indian corporate bodies. (Investors in CP)

Role of RBI in the Commercial Paper Market

The Working Group on Money Market (Vaghul Committee) in 1987 suggested the introduction of the commercial Paper (CP) in India. As per the recommendation of the committee, the RBI introduced commercial papers in January 1990. The Committee suggested the following:

(a) CP should be issued to investors directly or through bankers.

(b) The CP issuing company must have a net worth of not less then Rs. 5 crores.

(c) The issuing company's shares must be listed in the stock exchange.

(d) The minimum amount of issue should be Rs. 1 crore and the minimum denomination of Rs. 5 lakhs

(e) The CPs issuing cost should not exceed 1% of the amount raised.

(f) RBI is the sole authority to decide the size of issue and timing of issue.

(g) The instrument should not be subject to stamp duty at the time of issue and there should not be any tax deduction at source.

(h) The interest on CP shall be a market determined.

(i) The issuing companies should get certification of credit rating for every six months and 'A' grading enterprises may be permitted to enter the market.

6. Acceptance Market

Acceptance Market is another component of money market. It is a market for banker's acceptance. The acceptance arises on account of both home and foreign trade. Bankers acceptance is a draft drawn by a business firm upon a bank and accepted by that bank. It is required to pay to the order of a particular party or to the bearer, a certain specific amount at a specific date in future. It is commonly used to settle payments in international trade. Thus acceptance market is a market where the bankers' acceptances are easily sold and discounted.

7. Collateral Loan Market

Collateral loan market is another important sector of the money market. The collateral loan market is a market which deals with collateral loans. Collateral means anything pledged as security for repayment of a loan. Thus collateral loans are loans backed by collateral securities such as stock, bonds etc. The collateral loans are given for a few months. The collateral security is returned to the borrower when the loan is repaid. When the borrower is not able to repay the loan, the collateral becomes the property of the lender. The borrowers are generally the dealers in stocks and shares.

Structure of the Indian Money Market

In the Indian money market RBI occupies a key role. It is the nerve centre of the monetary system of our country. It is the leader of the Indian money market. The Indian money market is highly disintegrated and unorganized. The Indian money market can be divided into two sectors - unorganized and organised. In between these two, there exists the co-operative sector. It can be included in the organised sector.

The organised sector comprises of RBI, SBI group of banks, public sector banks, private sector banks, development banks and other financial institutions. The unorganised sector comprises of indigenous bankers, money lenders, chit funds etc. These are outside the control of RBI. This is the reason why Indian money market remains underdeveloped.

Features or Defects of the Indian Money Market

The features or defects of the Indian money market are as follows:

1. **Existence of unorganised segment**: The most important defect of the Indian money market is the existence of unorganised segment. The unorganised segment comprises of indigenous bankers, moneylenders etc. This unorganised sector does not follow the rules and regulations of the RBI. Besides, a higher rate of interest prevails in the unorganised market.

2. **Lack of integration:** Another important drawback of the Indian money market is that the money market is divided into different sections. Unfortunately these sections are loosely connected to each other. There is no co-ordination between the organised and unorganised sectors. With the setting up of the RBI and the passing of the Banking Regulations Act, the conditions have improved.

3. **Disparities in interest rates**: Interest rates in different money markets and in different segments of money market still differ. Too many interest rates are prevailing in the market. For example, borrowing rates of Govt. lending rate of commercial banks, the rates of co-operative banks and rates of financial institutions. This disparity in interest rates is due to lack of mobility of funds from one segment to another.

4. **Seasonal diversity of money market**: The demand for money in Indian money market is of seasonal in nature. During the busy season from November to June, money is needed for financing the marketing of agricultural products, seasonal industries such as sugar, jaguar, etc. From July to October the demand for money is low. As a result, the money rates fluctuate from one period to another.

5. **Absence of bill market:** The bill market in India is not well developed. There is a great paucity of sound commercial bills of exchange in our country. As a matter of habit, Indian traders resort to hundies rather than properly drawn bill of exchange.

6. **Limited instruments:** The supply of short term instruments like commercial

bills, treasury bills etc. are very limited and inadequate.

7. **Limited number of participants**: The participants in the Indian money market are limited. Entry in the money market is tightly regulated.

8. **Restricted secondary market:** Secondary market for money market instruments is mainly restricted to rediscounting of commercial bills and treasury bills.

9. **No contact with foreign money markets**: Indian money market has little contract with money markets in other countries.

Recent Developments in the Indians Money Market

The recent developments in the Indian money market may be briefly explained as below:

1. Integration of unorganised sector with the organised sector : RBI has taken many steps to bring the institutions in the unorganised sector within its control and regulation. These institutions are now slowly coming under the organised sector. They started availing of the rediscounting facilities from the RBI.

2. Widening of call money market: In recent years, many steps have been taken to widen the call money market. The number of participants in the call money market is increasing. LIC, GIC, IDBI, UTI and specialised mutual funds have been permitted to enter into this market as lenders only. The DFHI and STCI have been permitted to operate both as lenders and borrowers.

3. Introduction of innovative instruments: New financial instruments have been introduced in the money market. On the recommendation of the Chakkraborty Committee, the RBI introduced 192 days T-bills since 1986. A new instrument in the form of 364 days T-bills was introduced at the end of April 1992. Again, new instruments such as CDs, CPs, and interbank participation certificates have been introduced. Necessary guidelines also have been issued for the operation of these instruments.

4. Introduction of negotiable dealing system : As negotiable dealing system has been introduced with a view to facilitating electronic bidding in auctions and secondary market transactions in Govt. securities and dissemination of information.

5. Offering of market rates of interest: In order to popularise money market instruments, the ceiling on interest rate has been abolished. Call money rate, bill discounting rate, inter bank rate etc. have been freed from May 1, 1989. Thus, today Indian money market offers full scope for the play of market

forces in determining the rates of interest.

6. Satellite system dealership: The satellite system dealership was launched in 1996 to serve as a second tier to primary dealers in retailing of Govt. securities

RBI has decided to allow players such as provident funds, trusts to participate in government bond auctions, on a non-competitive basis.

7. Promotion of bill culture: All attempts are being taken to discourage cash credit and overdraft system of financing and to popularise bill financing. Exemption from stamp duty is given on rediscounting of derivative usance promissory notes arising out of genuine trade bill transactions. This is done to promote bill culture in the country.

8. Introduction of money market mutual funds: Recently certain private sector mutual funds and subsidiaries of commercial banks have been permitted to deal in money market instrument. This has been done with a view to expand the money market and also to develop secondary market for money market instruments.

9. Setting up of credit rating agencies: Recently some credit rating agencies have been established. The important agencies are the Credit Rating Information Services of India Ltd (CRISIL), Investment Information and Credit Rating Agency of India (IICRA) and, Credit Analysis and Research Ltd. (CARE). These have been set up to provide credit information through financial analysis of leading companies and industrial sectors.

10. Adoption of suitable monetary policy: In recent years the RBI is adopting a more realistic and appropriate monetary and credit policies. The main objective is to increase the availability of resources in the money market and make the money market more active.

11. Establishment of DFHI: The DFHI was set up in 1988 to activate the money market and to promote a secondary market for all money market instruments.

12. Setting up of Securities Trading Corporation of India Ltd. (STCI) : The RBI has set p the STCI in May 1994. Its main objective is to provide a secondary market in Govt. securities. It has enlarged the T-bill market and the call market and provided an active secondary market for T-bills.

Because of these recent developments, the Indian money market is developing.