What is Money Market?

Instruments Money Market Funds Certificate of deposit RBI Face value Under man

The money market is referred to as dealing in debt instruments with less than a year to maturity bearing fixed income. In this article, we will cover the meaning of money market instruments along with its types and objectives

Money Market is a financial market where short-term financial assets having liquidity of one year or less are traded on stock exchanges. The securities or trading bills are highly liquid. Also, these facilitate the participant's short-term borrowing needs through trading bills. The participants in this financial market are usually banks, large institutional investors, and individual investors.

There are a variety of instruments traded in the money market in both the stock exchanges, NSE and BSE. These include treasury bills, certificates of deposit, commercial paper, repurchase agreements, etc. Since the securities being traded are highly liquid in nature, the

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hence maintaining a balance between the demand and supply for money. Thus facilitating the development and growth of the economy.

Objectives

Below are the main objectives of the money market:

1. Providing borrowers such as individual investors, government, etc. with short-term funds at a reasonable price. Lenders will also have the advantage of liquidity as the securities in the money market are short-term.
2. It also enables lenders to turn their idle funds into an effective investment. In this way, both the lender and borrower are at a benefit.
3. RBI regulates the money market. Therefore, in turn, helps to regulate the level of liquidity in the economy.
4. Since most organizations are short on their working capital requirements. The money market helps such organizations to have the necessary funds to meet their working capital requirements.
5. It is an important source of finance for the government sector for both national and international trade. And hence, provides an opportunity for the banks to park their surplus funds.

Types of Money Market Instruments in India

1. Treasury Bills

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These instruments provide much better liquidity. As the same can be transferred from one person to another in case of immediate cash requirements.

3. Certificate of Deposit

Certificate of deposit or CD's is a negotiable term deposit accepted by commercial banks. It is usually issued through a promissory note.

CD's can be issued to individuals, corporations, trusts, etc. Also, the CD's can be issued by scheduled commercial banks at a discount. And the duration of these varies between 3 months to 1 year. The same, when issued by a financial institution, is issued for a minimum of 1 year and a maximum of 3 years.

4. Commercial Paper

Corporates issue CP's to meet their short-term working capital requirements. Hence serves as an alternative to borrowing from a bank. Also, the period of commercial paper ranges from 15 days to 1 year.

The Reserve Bank of India lays down the policies related to the issue of CP's. As a result, a company requires RBI's prior approval to issue a CP in the market. Also, CP has to be issued at a discount to face value. And the market decides the discount rate.

Denomination and the size of CP:

Minimum size – Rs. 25 lakhs

Maximum size – 100% of the issuer's working capital

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- The volume of traded assets is generally very high.
- It enables the short-term financial needs of the borrowers. Also, it deals with investments that have a maturity period of 1 year or less.
- It is still evolving. There is always a possibility of adding new instrument

What is maturity?

The maturity in respect of money market instruments means the time period within which the securities will mature. This is generally less than a year in case of money market instruments.

What is the yield on security?

In simple words, the yield is the interest rate earned by investing securities It can be calculated by the below formula:

Yield = (Face value – Sale value)/sale value* (days or months in a year/period of discount)*100

Let's understand the above with the help of an example:

Face value or amount of issue – Rs. 100
Period – 6 months
Discount rate – 10%
Discount – 100*(6/12)*(10/100) = Rs. 5

By using the above formula for yield we get

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Financing needs	These instruments are used to fund the short-term needs of the borrower.	Used for long-term fund requirements.
Types of instruments	It has instruments like T-bills, certificate of deposits, inter-bank call money, etc.	It's a stock of an independently listed company
Degree of risk	Risk is comparatively lower due to the short-term maturity period	Risk is higher.

What are Money Market Funds?

Money market mutual funds, MMMFs are highly liquid open-ended dent funds generally used for short term cash needs. The money market fund deal only in cash and cash equivalents with an average maturity of an year with fixed income

The fund manager invests in money market instruments like treasury bills, commercial paper, certificate of deposits, bills of exchange etc.

What factors determine interest rates of money market instruments?

Currently, the interest rate is dependent on the market forces of demand for; and supply of short term money.

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- It finances short term needs of the government and economy. Any business or organisation can borrow money at short notice for a short term.
- Helps in utilising surplus funds in the market for a short term to earn an additional return. It channelises savings to investments.
- Assists in mobilising funds from one sector to another with the utmost transparency
- Guides in devising monetary policies. The current money market conditions are the result of previous monetary policies. Hence it acts as a guide for devising new policies regarding short term money supply.

What are the characteristics of money market instruments?

- It is a financial market and has no fixed geographical location.
- It is a market for short term financial needs, for example, working capital needs.
- It's primary players are the Reserve Bank of India (RBI), commercial banks and financial institutions like LIC, etc.,
- The main money market instruments are Treasury bills, commercial papers, certificate of deposits, and call money.
- It is highly liquid as it has instruments that have a maturity below one year.
- Most of the money market instruments provide fixed returns.

What is the importance of the money market?

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instruments, it finances working capital requirements. It helps develop the trade in and out of the country.

- The short term interest rates influence long term interest rates. The money market mobilises the resources to the capital markets by way of interest rate control.
- It helps in the functioning of the banks. It sets the cash reserve ratio and statutory liquid ratio for the banks. It also engages their surplus funds towards short term assets to maintain money supply in the market.
- The current money market conditions are the result of previous monetary policies. Hence it acts as a guide for devising new policies regarding short term money supply.
- Instruments like T-bills, help the government raise short term funds. Otherwise, to fund projects, the government will have to print more currency or take loans leading to inflation in the economy. Hence the money market is also responsible for controlling inflation.

Frequently Asked Questions

What is the difference between the money market and capital market?

The money market is the component of a financial market that deals with short term borrowings. On the other hand, the capital market is also a component of the financial market that allows long term trading of equity and debt securities.
Money markets deal in short term lending, borrowing, buying and selling. In contrast, capital markets deal in long term lending or borrowing. Corporations or investors with

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What is the T bill?

What are the instruments of the money market and capital market?

Is Fd a money market instrument?

What are the risks of a money market fund?

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