Money Markets

Topics

- Concept and Evolution of Money Markets in India
- Different types of Money Market Products
- Regulation of Money Market in India

Money Market

- Money market forms an essential component of Indian Financial system.
- Short-term monetary assets with a maturity period up to one year are issued and traded in money markets.
- The important and attractive feature of money markets is high liquidity. It means the assets in money market can be quickly converted to money.
- Unlike capital markets there is no loss in the face value of the investment when the asset is sold or liquidated.
- Since the underlying transaction costs are also low, this market captures the attention of the investors who are looking to deal with their surpluses for short periods.
- More than the individuals, banks and financial institutions largely operate in this market. The RBI, which regulates this market, also participates in it through sale and purchase of instruments like Treasury Bills in order to finance the fiscal deficit requirements of the Indian economy.
- Apart from Banks and Financial institutions other players who actively take part in the market are Mutual funds and Investment Companies.

Money Market Contd..

- The money market is inherently vibrant market because of the short-term instruments that are issued and matured every week and the settlements happen on a daily basis.
- Because of the active participation of the interested entities the volume of the transactions are generally large.
- The instruments that are traded in money markets carry low-risk and hence the investors who are not willing to take risk but require assured returns consider them as safe bets.

Functions of the Money Market

- Money market is a very dynamic and active market and its focus is on addressing the following functions
- Money market is the means in which the central bank regulates the credit flow and the underlying interest rates
- It is one of the important avenues for commercial banks in India to maintain the mandatory statutory liquidity ratio requirements
- Money markets important role is ensure the availability of short-term funds to fund seekers like corporate, government and traders and at the same time act as an avenue for the investors with short-term surplus to park their investments.
- As far as market place for money market is concerned, there is no specific place or venue where the transactions are carried out.
- The fund issuers and fund seekers can transact on email, phone or any medium.

Functions of the Money Market Contd..

The fund seekers are generally

- Brokers
- Government
- Government Institutions
- Corporate
- Traders
- Merchants

Whereas the fund issuers are

- The Central Bank i.e. RBI
- Commercial Banks
- Financial Institutions
- Insurance Companies

Concept and Evolution of Money Markets in India

- Money Market deals with short-term borrowing and lending of funds, whose maturity ranges from as low as one day to as high as one year.
- This market is dominated by few large players and hence it witnesses high value and high volume transactions.
- The Money market in India is an important segment of the financial market, which is regulated by Reserve Bank of India.
- One of the important objectives of Money markets is to monitor and control the supply of money in the economy through the apex bank of India i.e. RBI.
- Apart from that monetary markets are best possible avenues for the investors who are interested in parking their funds for short durations and gain decent returns.
- Money markets also play a key role in meeting the short-term financing requirements at attractive interest rates and decent costs.

Growth of Money Market in India

- Money market in India has been in existence even before the RBI came into existence. But the growth of Money market in India has been tremendous only after liberalization started.
- There are two important committees, whose recommendations led to the growth of money market.
  - Review of the working of the monetary system by SukhmoyChakravarty Committee
  - Report on the working of the Financial system by Narasimham Committee
- Based on their recommendations, RBI implemented the following reforms to facilitate the growth of Money market.
  - Reduction in ceiling rate on bank advances and inter-bank call and short-notice money
  - Drastic reduction in minimum lending rates of commercial banks.
  - Interest rates are set to be determined by the market rather than the administered mechanism
- These reforms facilitated the massive growth of the money market with the increase in the number of participants and instruments.
- Since Liquidity is a key ingredient of the money market, besides the primary market an active secondary market has been created so that these money market instruments can be actively traded in order to facilitate the participants with quick liquidity option.

Different types of Money Market Products

Following are the list of Money market instruments that are available for investors who are looking forward to park their investments for short durations.

- Treasury Bills
- Certificates of Deposits
- Inter-Corporate Deposits
- Commercial Bills
- Commercial Paper

Treasury Bills

- Treasury bills or T-bills are the money market instruments issued by the Reserve Bank of India. RBI issues T-Bills in order to meet the short finance requirements of the Indian Government.
- Since they are being issued by the central bank itself, the risk associated with these instruments is low. These instruments are not issued at face value rather they are issued at a discounted value to that of face value.
- On maturity the return received by the investor is the difference between this issue price/discounted value and Face value. Hence they are called as Zero-Coupon Securities i.e. no interest or coupon amount is paid in between or at maturity.
- Generally the interest rates offered on savings and fixed deposits with a duration less than an year are less when compared to the interest rates that are available on T-bills. Hence it wise to consider T-Bills over Fixed and Savings Deposits for short term guaranteed returns.
- Since T-bills come at various days to maturity, the liquidity requirements of the investor can be met in a better way. It is not only for individual investors but also for business house that has surplus cash in their current accounts; T-bills remain on the best short term investment alternatives giving decent returns.

Treasury Bills Contd..

- An investor can avail the following benefits if he invests in T-Bills
- Since they are issued by the central bank, the transparency levels are very high and hence the secondary market for active trading too is very high
- Since the subscription and trading are very high, there is no concern about liquidity
- They provide comparatively better returns
- The risk levels too are negligible as the instruments are directly coming from RBI
- With no deduction of tax at source, the settlement process looks simple and easy
- Treasury bills are issued with the following days to maturity
- 14-days
- 91-days
- 182-days
- 364-days

Treasury Bills Contd..

- **14-days T-Bill**
- These treasury bills are put to auction in every week on Fridays.The amount notified for auction happens to be INR 100 crores.
- **91-days T-Bill**
- These treasury bills are put to auction in every week on Fridays. The amount notified for auction happens to be INR 100 crores.
- **182-days T-Bill**
- These treasury bills are put to auction in every week on Wednesdays, preceding non-reporting Fridays. The amount notified for auction happens to be INR 100 crores.
- **364-days T-Bill**
- These treasury bills are put to auction in every week on Wednesdays, preceding reporting Fridays. The amount notified for auction happens to be INR 100 crores.

Treasury Bills Contd..

- The major participants of T-Bill auctions happen to be the banks because T-Bills act as an important avenue for them to maintain the obligation of Statutory Liquid Ratio (SLR) requirements.
- Investors who got T-Bills allocated in the auction i.e. primary market can trade these instruments in the secondary market.
- Since the transaction costs involved in trading of these T-Bills is low, they are actively and immediately traded during two periods.
- After issue
- Before redemption

Certificate of Deposits

- These deposits are issued by Banks and other eligible financial institutions allowed by RBI.
- Regional Rural Banks and Local Area Banks are exempted from issuing Certificate of Deposits.
- They are issued for the duration not less than a week and not more than a year by the banks whereas financial institutions can issue certificate of deposits for a minimum period of over and above 1 year and for a maximum period of 3 years.
- The limit on the amount of short-term resources that can be raised by these entities is set by RBI.
- The minimum amount for which a certificate of deposit is issued should be INR 1 lakh. The investor thereafter can purchase them in the multiples of INR 1 lakh.

Inter-Corporate Deposits

- Other than Certificates of Deposits, the other provision for corporate to secure short-term finance is Inter-Corporate Deposits (ICDs).
- ICDs are unsecured finances offered by one corporate to another corporate. ICDs are normally issued by the corporate with large surpluses to the corporate that are in need of short-term loans.
- Generally this market is dominated by corporate with good credit rating who get loans at a better rate from the financing agencies and lend them to corporate with less credit rating and have no access to better financing.
- Since financing agencies are very particular about the credit rating of the entities they issues loans to, corporate who are better placed in terms of credit ratings issue ICDs at higher interests, thereby earning higher returns.
- Since ICDs are unsecured loans the risk is equally high. The market for ICDs is unorganized in nature and normally dealt between two entities.

Commercial Bills

- Commercial bills are negotiable instruments between buyer and seller of goods and services when the transaction takes place on credit.
- They are bills of exchange which can be encashed by the seller upon maturity.
- Alternatively the seller can endorsed them to a third party upon payment of dues the buyer of goods and services owes him.
- In general practice the seller discounts the bills of exchange with any financial institution or a bank and collects his money.
- The discount rate is the benefit obtained by the financial institution or a bank.

Commercial Paper

- It is an additional money market instrument introduced in Indian market in 1990 which enables the corporate borrowers with high credit rating to meet their short term finances.
- It is an unsecured instrument which is issued in the form of a promissory note.
- Apart from corporate companies, approved financial institutions and primary dealers can issue Commercial papers to finance their short-term requirement of funds to carry out their operations.

An entity can issue a commercial paper only when

- The tangible net worth of the company is more than INR 4 crore as per its latest Balance Sheet which is audited
- The Financing entity should classify its borrowal account as Standard Asset
- Its working capital limit has been sanctioned by the Financial Institution or a Bank

Commercial Paper Contd..

- Generally a commercial paper is issued for duration of minimum one week and the maximum period is one year.
- The minimum denomination for which a commercial paper can issued is INR 5 Lakh.
- Any additional issue or purchase should in the multiple of INR 5 Lakh.
- Based upon the understanding between the issuer and subscriber A commercial paper can be issued in a paper form or dematerialized format.

Regulation of Money Market in India

- The Reserve Bank of India (RBI) regulates the money market in India. The guidelines towards governance of money market operations too are issued and monitored by the RBI.
- The interest rates of the money market are largely influenced by timely intervention of RBI. Whenever there is more liquidity in the market RBI sells treasury bills apart from increasing the key rates like Cash reserve ratio (CRR) and statutory liquid ratio (SLR).
- These measures reduce the money supply in the market. Whenever the economy is experiencing high levels of inflation RBI steps in and resorts to these initiatives.
- When the inflations levels are well within the control and if the economy needs to be boosted in terms of growth RBI adopts an opposite approach.
- The statutory rates like CRR and SLR are reduced and also the treasury bills issued are brought from the money market.
- With these steps, the supply of money in the economy increase, thereby facilitating a favorable condition for its growth prospects.

Thank You