

Unit-3

- **What in financial Market?**

Financial markets refer broadly to any marketplace where the trading of securities occurs, including the stock market, bond market, forex market, and derivatives market, among others.

- **What are two broad categories of financial Market?**

Money Market and capital Market.

- **What is Money Market?**

Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers.

- **What is Capital Market?**

Capital market is a market where buyers and sellers engage in trade of financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Generally, this market trades mostly in long-term securities.

Mention the institution of Money Market.

- Commercial bank
- Central Bank
- Acceptance House
- Non banking financial intermediaries.

Mention the instruments of capital market?

- Shares
- Debentures
- Forwards
- Futures
- Options
- Global Depository Receipts

Q.what are the instruments of money market?

- Commercial bills
- Treasury bills
- Commercial paper
- Certificate of deposits
- Repos etc

Q.what are the characteristics or features of Money Market?

1. Money market has no geographical constraints as that of a stock exchange. The financial institutions dealing in monetary assets may be spread over a wide geographical area.

2. Even though there are various centers of money market such as Mumbai, Calcutta, Chennai, etc., they are not separate independent markets but are inter-linked and interrelated.
3. It relates to all dealings in money or monetary assets.
4. It is a market purely for short-term funds.
5. It is not a single homogeneous market. There are various sub-markets such as Call money market, Bill market, etc.
6. Money market establishes a link between RBI and banks and provides information of monetary policy and management.
7. Transactions can be conducted without the help of brokers.
8. Variety of instruments are traded in money market.

Q.what are the functions and importance of money market?

1. Financing Trade:

Money Market plays crucial role in financing both internal as well as international trade. Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market. The acceptance houses and discount markets help in financing foreign trade.

2. Financing Industry:

Money market contributes to the growth of industries in two ways:

- (a) Money market helps the industries in securing short-term loans to meet their working capital requirements through the system of finance bills, commercial papers, etc.
- (b) Industries generally need long-term loans, which are provided in the capital market. However, capital market depends upon the nature of and the conditions in the money market. The short-term interest rates of the money market influence the long-term interest rates of the capital market. Thus, money market indirectly helps the industries through its link with and influence on long-term capital market.

3. Profitable Investment:

Money market enables the commercial banks to use their excess reserves in profitable investment. The main objective of the commercial banks is to earn income from its reserves as well as maintain liquidity to meet the uncertain cash demand of the depositors. In the money market, the excess reserves of the commercial banks are invested in near-money assets (e.g.

short-term bills of exchange) which are highly liquid and can be easily converted into cash. Thus, the commercial banks earn profits without losing liquidity.

4. Self-Sufficiency of Commercial Bank:

Developed money market helps the commercial banks to become self-sufficient. In the situation of emergency, when the commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higher interest rate. On the other hand, they can meet their requirements by recalling their old short-run loans from the money market.

5. Help to Central Bank:

Though the central bank can function and influence the banking system in the absence of a money market, the existence of a developed money market smoothens the functioning and increases the efficiency of the central bank.

Money market helps the central bank in two ways:

- (a) The short-run interest rates of the money market serves as an indicator of the monetary and banking conditions in the country and, in this way, guide the central bank to adopt an appropriate banking policy,
- (b) The sensitive and integrated money market helps the central bank to secure quick and widespread influence on the sub-markets, and thus achieve effective implementation of its policy.

Q.Discuss about the participants or institution of money market.

1. Central Government:

Central Government is a borrower in the money market through the issue of Treasury Bills (T-Bills). The T-Bills are issued through the RBI. The T-Bills represent zero risk instruments. They are issued with tenure of 91 days (3 months), 182 days (6 months) and 364 days (1 year). Due to its risk free nature, banks, corporates and many such institutions buy the T-Bills and lend to the government as a part of its short- term borrowing programme.

2. Public Sector Undertakings:

Many government companies have their shares listed on stock exchanges. As listed companies, they can issue commercial paper in order to obtain its working capital finance. The PSUs are only borrowers in the money market. They seldom lend their surplus due to the bureaucratic mindset. The treasury operations of the PSUs are very inefficient with huge cash surplus remaining idle for a long period of time.

3. Insurance Companies:

Both general and life insurance companies are usual lenders in the money market. Being cash surplus entities, they do not borrow in the money market. With the introduction of CBLO (Collateralized Borrowing and Lending Obligations), they have become big investors. In between capital market instruments and money market instruments, insurance companies invest more in capital market instruments. As their lending programmes are for very long periods, their role in the money market is a little less.

4. Mutual Funds:

Mutual funds offer varieties of schemes for the different investment objectives of the public. There are many schemes known as Money Market Mutual Fund Schemes or Liquid Schemes. These schemes have the investment objective of investing in money market instruments.

They ensure highest liquidity to the investors by offering withdrawal by way of a day's notice or encashment of units through Bank ATMs. Naturally, mutual funds invest the corpus of such schemes only in money market. They do not borrow, but only lend or invest in the money market.

5. Banks:

Scheduled commercial banks are very big borrowers and lenders in the money market. They borrow and lend in call money market, short-notice market, repo and reverse repo market. They borrow in rediscounting market from the RBI and IDBI. They lend in commercial paper market by way of buying the commercial papers issued by corporates and listed public sector units. They also borrow through issue of Certificate of Deposits to the corporates.

6. Corporates:

Corporates borrow by issuing commercial papers which are nothing but short-term promissory notes. They are issued by listed companies after obtaining the necessary credit rating for the CP. They also lend in the CBLO market their temporary surplus, when the interest rate rules very high in the market. They are the lender to the banks when they buy the Certificate of Deposit issued by the banks. In addition, they are the lenders through purchase of Treasury bills.

There are many other small players like non-banking finance companies, primary dealers, provident funds and pension funds. They mainly invest and borrow in the CBLO market in a small way.