Money Market

and

Money Market Instruments

MONEY MARKET

IN INDIA

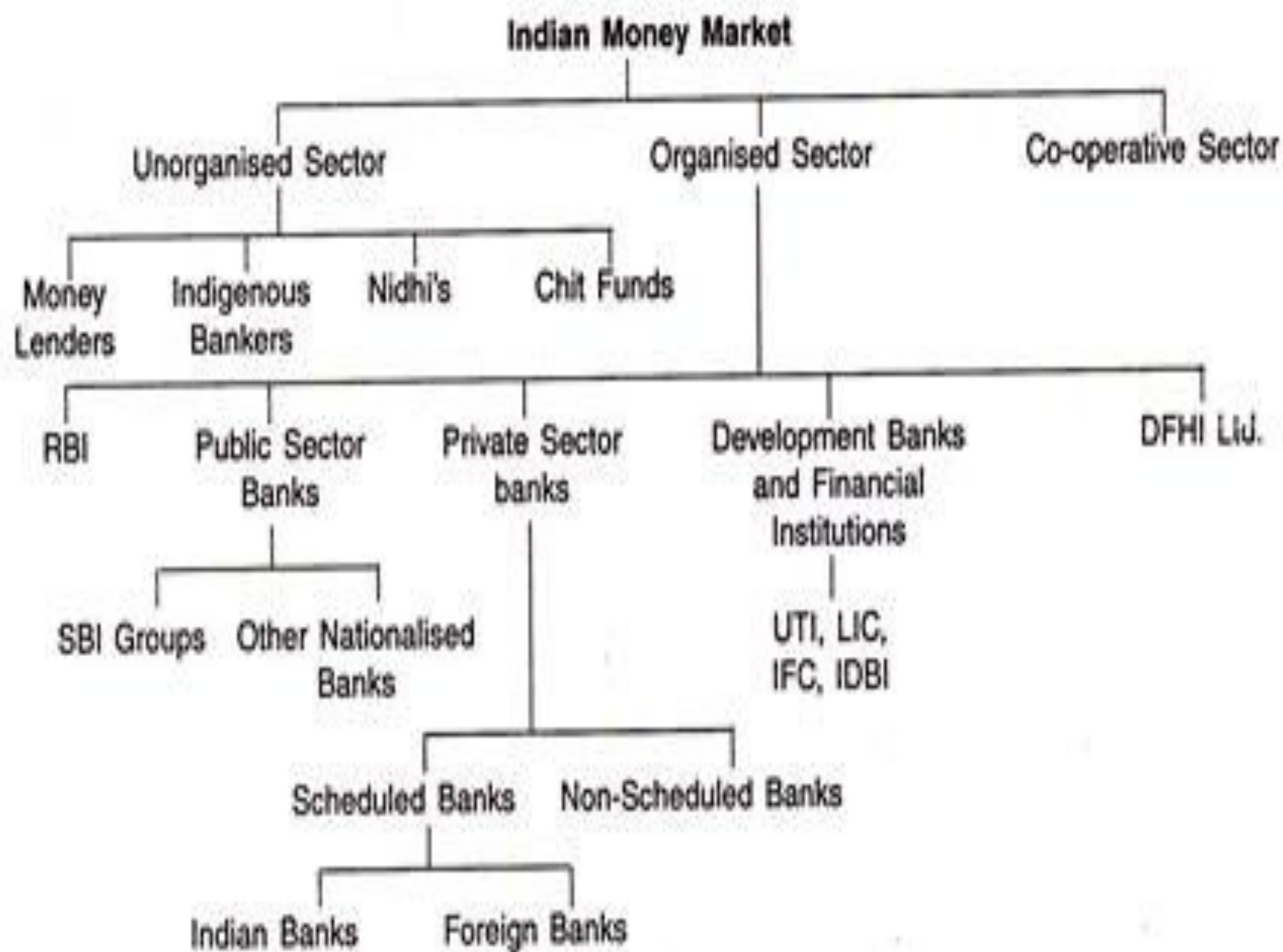


CHART 14.3. Indian Money Market
Indian Money Market
Unorganised Sector
Organised Sector
Co-operative Sector
Money Lenders
Indigenous Bankers
Nidhi's
Chit Funds
RBI
Public Sector Banks
Private Sector banks
Development Banks and Financial Institutions
DFHI Ltd.
SBI Groups
Other Nationalised Banks
UTI, LIC, IFC, IDBI
Scheduled Banks
Non-Scheduled Banks
Indian Banks
Foreign Banks

What is Money Market?

- It is the market where short term financial instruments that mature within a year or earlier are traded.
- 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.

Examples -:of short-term fund requirements

- Say need for working capital by a company.
- Loan for travelling abroad for a trip
- Loan to construct a section of a house etc.

Money Market

- Money market is a mechanism that deals with the lending of short term funds (less than one year)

- A segment of the financial market in which financial instrument with high liquidity and very short maturities are traded.

Features of Money market

- →Money Market instruments or short-term financial assets **are near substitutes for money.**
- → **The risk of capital losses (money risk) and risk of default are very low** in comparison to capital market.
- Since the change in interest rates does not affect their prices very much due to short period maturity, money market risk is very low.
- Further, the default risk is also very low because major participants in this market are governments, central bank, commercial banks and other important institutions.
- That is why money market instruments are most liquid and can be turned over quickly at low transaction cost without loss.

Features(contd.)

- It is the place where temporary cash surpluses are adjusted with temporary cash deficits. So it assures the borrowers that they can obtain short term funds quickly and the lenders to convert their short term financial assets into cash.
- The major players and institutions of this market are the Reserve Bank of India, all the commercial banks of the country, NBFC's, LIC, Mutual Funds, large corporates, individual investors and even the respective state governments.

Features(contd.)

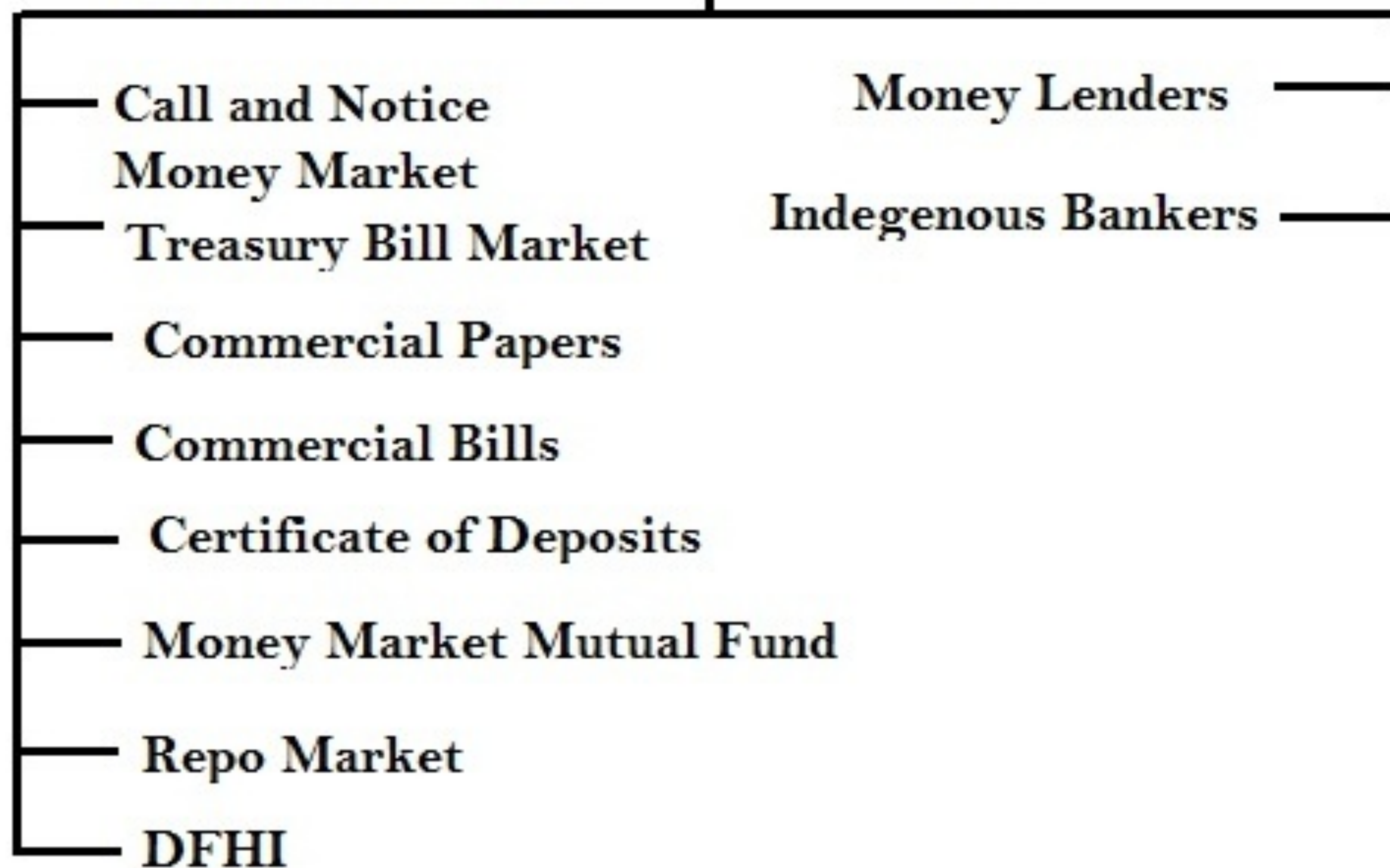
- Unlike the stock exchange, the money market does not have geographical restrictions. Most transactions happen in the virtual world with institutions that can be spread out over the whole country, the whole world even.
- While the market is quite flexible and unrestricted, it only deals in short-term securities (maturity period between one day and 364 days)
- There is no need for brokers or other intermediaries. The transactions can happen without them.

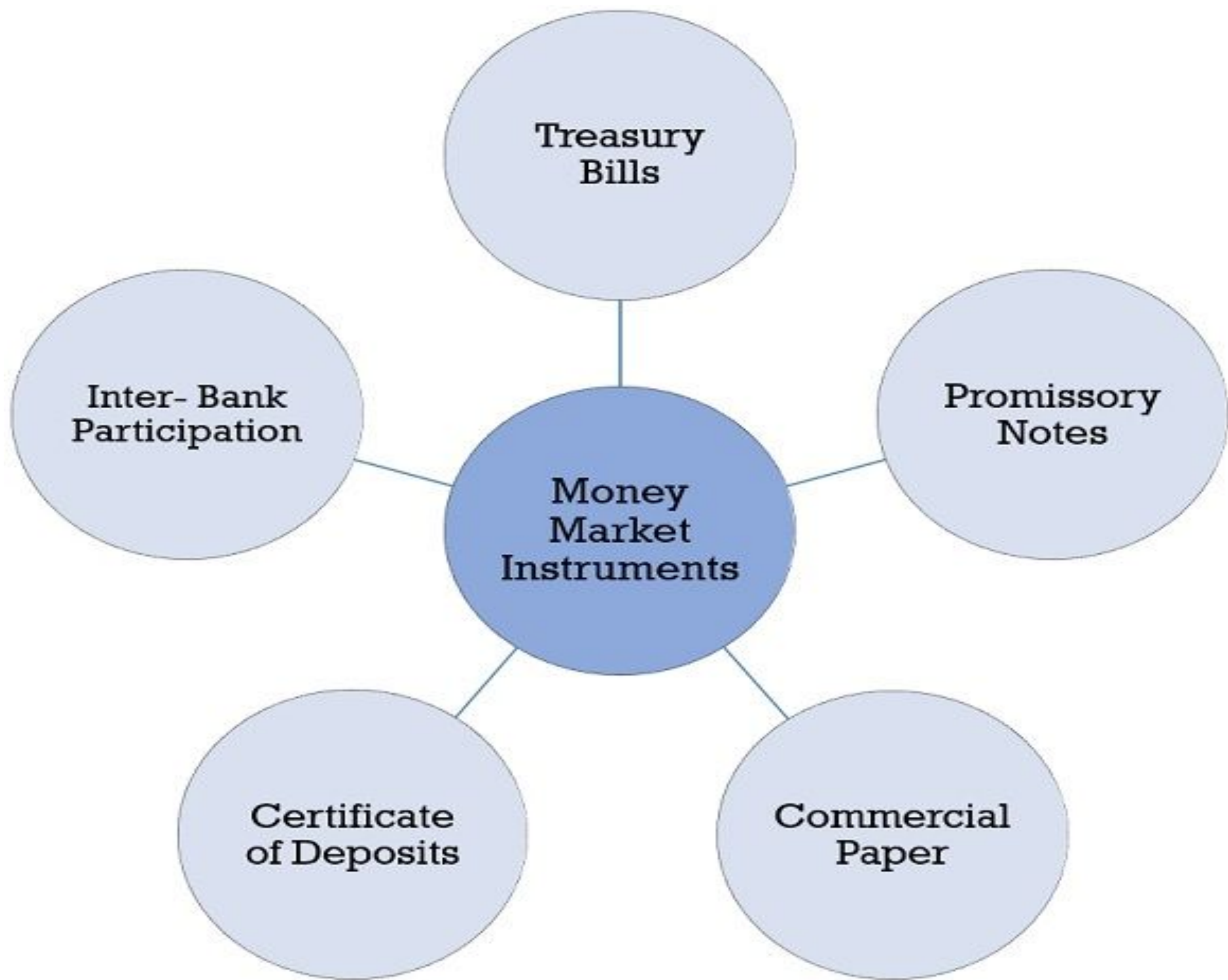
Objectives

- Borrowers gets short-term funds at a reasonable price.
- Lenders have the advantage of liquidity due to the short term maturity of securities in the money market .
- RBI regulates the money market and thereby can regulate the level of liquidity in the economy.
- Money market helps the organizations to have the necessary funds to meet their working capital requirements.
- It is an important source of finance for the government sector for both national and international trade.

MONEY MARKET INSTRUMENTS

Money Market in India




Treasury Bills
Inter- Bank Participation
Promissory Notes
Money Market Instruments
Certificate of Deposits
Commercial Paper

Let us know in details about some of these Money market instruments:

- 1. Treasury Bills
- 2. Commercial Papers
- 3. Certificate of Deposits
- 4. Commercial Bills
- 5. Call Money market
- 6.REPO
- 7. Bankers' Acceptance

1. Treasury Bills

- They are money market instruments issued by the Government of India as a promissory note with guaranteed repayment at a later date.
- These funds are collected to meet short term requirements of the government so as to finance the fiscal deficit of the country.

Types of Treasury Bill →They are distinguished based on their tenure as shown below

- 14-day treasury bill
- 91-day treasury bill
- 182-day treasury bill
- 364-day treasury bill
- The Government of India issues it at a discount for 14 days to 364 days.

Treasury Bills (contd.)

- They are issued at a discount to the published nominal value of government security (G-sec) and are repaid at par at the time of maturity, thereby allowing investors to pocket the difference.
- **They don’t yield any interest rate to the investors.** Upon redemption of these G-sec securities, the entire par value of this bond is paid to investors, thereby allowing them to realise substantial profits on total investment.
- They are issued in lots of Rs. 25,000 for 14 days & 91 days and Rs. 1,00,000 for 364 days.

Treasury Bills (contd.)

- For example, a 91-day treasury bill with a face value of Rs. 120 can be bought at a discounted price of Rs. 118.40. Upon maturity, individuals are eligible to receive the entire nominal value of Rs. 120, which allows them to realise a profit of Rs. 1.60.

Treasury Bills (contd.)
Objectives

- →It helps the government to raise funds to meet its current expenditure over its current annual revenue.
- → It is s aimed at reducing total fiscal deficit in an economy,
- → It is an integral monetary policy tool which is used by the RBI to regulate the totalmoney supply in an economy.

Features of Treasury Bills

- **Minimum investment** → to be made to acquire it by the investors is ₹25000 as per RBI regulations and any higher investment has to be made in multiples of Rs. 25,000.
- **Zero-coupon securities** : It is a zero interest investment as the government gives no interest rate on treasury bills.

Trading of treasury bills:

- The RBI, on behalf of the central government, auctions such securities every week in the market, depending upon the total bids placed on major stock exchanges.
- They can be procure through:
- depository participant commercial banks
- or other registered primary dealers (PDs) or , several open-ended mutual funds etc
- **The security transfer follows a T+1settlement process.**

T+1 settlement cycle means >>

- T+1 settlement cycle means any trade-related settlements must be completed within one day from the day of the transaction. For instance, if you have brought a share on Tuesday, it will be credited to your Demat account by Wednesday.

Disadvantages of Treasury bills:

- 1. **They generate relatively lower returns** when compared to standard stock market investment tools.
- 2. **They are zero-coupon securities,** issued at a discount to investors. Hence, total returns generated by such instruments remain constant through the tenure of bond, irrespective of economic conditions and business cycle fluctuations in contrast to the stock market, wherein market variations heavily influence returns generated by both equity and debt tools.

Disadvantages of Treasury Bill investment (contd.)

- **Contd**. Consequently, in the event of an upswing in the stock market, the yield rate of associated tools is significantly higher than the capital gains generated through G-Sec investments.
- **Taxation:** Short term capital gain (STCG) realised on these bills is subject to STCG tax at rates applicable as per the income tax slab of an investor.

2. Commercial Bills

- Commercial bills, also a money market instrument, works more like the bill of exchange.
- Businesses issue them to meet their short-term money requirements. These instruments provide much better liquidity.
- As the same can be transferred from one person to another in case of immediate cash requirements.

Commercial bill→how it works.

- It is a bill of exchange used to finance the **credit sales of firms**. It is a short term, negotiable and self liquidity instrument.
- **In case of goods sold on credit**, the buyer is liable to make the payment on a specific date in future. The seller could either wait till the maturity date or can **draw a bill of exchange.** When this bill is accepted by the buyer it becomes a marketable instrument and is **called a trade bill.**
- If the seller wants the funds before the maturity date, he can get the bill discounted from the bank. **When a commercial bank accepts a trade bill it becomes a commercial bill.**

3. Certificate of Deposit

- Certificate of deposit or CD's is a negotiable term deposit accepted by commercial banks.
- A certificate of deposit (CD) is a savings account that holds a fixed amount of money for a fixed period of time, such as six months, one year, or five years, and in exchange, the issuing bank pays interest. When you cash in or redeem your CD, you receive the money you originally invested plus any interest.

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

5. Call Money

- It is a segment of the market where scheduled commercial banks lend or borrow on short notice (say a period of 14 days) to manage day-to-day cash flows.
- The money that is lent for one day in this market is known as "**call money**“.
- If it exceeds one day, is referred to as "**notice money**.
- If it’s lent for more than 15 days, then it’s called **“Term Money”.**

The interest rate paid on call money is known as the **call rate.** It is a highly volatile rate that varies from day to day and sometimes even from hour to hour.

- There is an **inverse relationship** between call rates and other **short-term money market instruments** such as certificates of deposit and commercial paper.
- A rise in call money rates makes other sources of finance, such as commercial paper and certificates of deposit, cheaper in comparison for banks to raise funds from these sources.

Functions of Call Money Market:

- It provides an equilibrating mechanism for evening out short term surpluses and deficits.
- Banks can quickly borrow from the call market to meet their mandatory funding requirements as set by the Reserve Bank of India which are the statutory liquidity requirements(SLR) and Cash Reserve Ratio (CRR) .
- They can maximize their profits easily by investing their surplus funds in the call market during the period when call rates are high and volatile.
- Can meet the funding requirements during a period of high cash outflow.
- To tend to temporary funding discrepancies.

How Does a Call Money Market Work?

- In a Call Money Market (CMM), loans are offered by the participants in the form of auctions and the borrowers place bids for the same. These bids are made on the interest rate. So, a bidder who is offering the highest interest rate on a particular loan gets the funds.
- Dealing of the money in a CMM is done through a Negotiated Trading System (NDS) which is a regulated electronic trading platform.

Important Features of CMM:

- The average interest rate offered in the CMM is called a call rate.
- A call rate is an important factor in determining the liquidity status of the economy and is thus actively monitored by the RBI.
- Since most of the participants in a CMM are banks, a call rate can tell the financial situation of the economy. **For instance, if the call rate is high then it indicates liquidity stress and vice versa.**

The **participants** in call money market can be classified into categories:

- I→ Those permitted to act as both lenders and borrowers of call loans. This first category includes all commercial banks. Co-operative banks, DFHI(Discount and Finance House of India) and STCI (Securities Trading Corporation of India) .
- II → Those permitted to act only as lenders in the market. This second category includes LIC, UTI, GIC, IDBI, NABARD, specified mutual funds etc., are included. They can only lend and they cannot borrow in the call market.

6. **Banker's Acceptances**

- The banker’s acceptance is a short-term loan that is guaranteed by a bank.
- They are used extensively in foreign trade, a banker's acceptance is like a post-dated check and serves as a guarantee that an importer can pay for the goods.
- They are transacted in the secondary market at a discount.

7. REPO: Repurchase Agreement or Repurchase Option

- The repo, or Repurchase Agreement(repo) is part of the overnight lending money market.
- Treasury bills or other government securities are sold to another party with an agreement to repurchase them at a set price on a set date.

What is the yield on security?

- In simple words, the yield is the interest rate earned by investing in the securities .
- It is calculated by the 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
- Y = (100-95)/95*(12/6)*100
  = 10.52%

Calculate the Yield Rate on Treasury Bills

- If the RBI issues a 91-day treasury bill at a discounted value of Rs.98 while the face value of the bill is Rs. 100, calculate the yield on such G-Secs ???

Answer: Yield rate on the G-sec is →→

- Yield = (100 – 98)/98 x 365/91 x 100

= 8.19%

ADVANTAGES AND DISADVANTAGES OF MONEY MARKET INSTRUMENT

Advantages:

- High Liquidity
- High Profitability
- Use of surplus fund
- Low risk
- Call rates helps in knowing market situation

Disadvantages:

- Low returns than in capital market
- High Volatility

Thank you

- Thank you