**Money Market**

**Meaning of Money Market:**

Money market is a market for short-term funds. We define the short-term as a period of 364 days or less. In other words, the borrowing and repayment take place in 364 days or less. The manufacturers need two types of finance: finance to meet daily expenses like purchase of raw material, payment of wages, excise duty, electricity charges etc., and finance to meet capital expenditure like purchase of machinery, installation of pollution control equipment etc.

In simple words, the money market is an avenue for borrowing and lending for the short-term. While on one hand the money market helps in shifting vast sums of money between banks, on the other hand, it provides a means by which the surplus of funds of the cash rich corporations and other institutions can be used (at a cost) by banks, corporations and other institutions which need short-term money.

The money market is a market where money and highly liquid marketable securities are bought and sold. It is not a place like the stock market but an activity and all the trading is done through telephones. One of the important features of the money market is honor of commitment and creditworthiness.

**Features and Objectives of Money Market:**

**Features of Money Market:**

**Following are the features of money market:**

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

2. It relates to all dealings in money or monetary assets.

3. It is a market purely for short-term funds.

4. It is not a single homogeneous market. There are various sub-markets such as Call money market, Bill market, etc.

5. Money market establishes a link between RBI and banks and provides information of monetary policy and management.

**Objectives of Money Market:**

1. To meet the requirements of borrowers for short term funds, and provide liquidity to the lenders of these funds.

2. To provide parking place for temporary employment of surplus fund.

3. To provide facility to overcome short term deficits.

4. To enable the central bank to influence and regulate liquidity in the economy.

5. To help the government to implement its monetary policy through open market operation.

**Structure of Indian Money Market:**

The money market in India has two sectors- (a) Organised sector, and (b) Unorganised sector.

(a) The organised sector consists of the Reserve Bank of India, nationalised commercial banks, other scheduled and non-scheduled commercial banks, foreign banks, and Regional Rural Banks. It is called organised because its part is systematically coordinated by the RBI.

Non-bank financial institutions such as the LIC, the GIC and subsidiaries, the UTI also operate in this market, but only indirectly through banks, and not directly.

Cooperative credit institutions occupy the intermediary position between organised and unorganised parts of the Indian money market.

(b) The unorganised sector consists of indigenous banks and money lenders. It is unorganised because activities of its parts are not systematically coordinated by the RBI.

The money lenders operate throughout the country, but without any link among themselves.

**Constituents of Indian Money Market:**

Money market is a centre where short-term funds are supplied and demanded. Thus, the main constituents of money market are the lenders who supply and the borrowers who demand short-term credit.

**I. Supply of Funds:**

**There are two main sources of supply of short-term funds in the Indian money market:**

(a) Unorganised indigenous sector, and

(b) Organised modern sector.

**(i) Unorganized Sector:**

The unorganised sector comprises numerous indigenous bankers and village money lenders. It is unorganized because its activities are not controlled and coordinated by the Reserve Bank of India.

**(ii) Organized Sector:**

**The organized modern sector of Indian money market comprises:**

(a) The Reserve Bank of India;

(b) The State Bank of India and its associate banks;

(c) The Indian joint stock commercial banks (scheduled and non-scheduled) of which 20 scheduled banks have been nationalised;

(d) The exchange banks which mainly finance Indian foreign trade;

(e) Cooperative banks;

(f) Other special institutions, such as, Industrial Development Bank of India, State Finance Corporations, National Bank for Agriculture and Rural Development, Export-Import Bank, etc., which operate in the money market indirectly through banks; and

(g) Quasi-government bodies and large companies also make their funds available to the money market through banks.

**II. Demand for Funds:**

In the Indian money market, the main borrowers of short-term funds are: (a) Central Government, (b) State Governments, (c) Local bodies, such as, municipalities, village panchayats, etc., (d) traders, industrialists, farmers, exporters and importers, and (e) general public.

**Sub-Markets of Organised Money Market:**

**A. Call Money Market:**

The most important component of organised money market is the call money market. It deals in call loans or call money granted for one day. Since the participants in the call money market are mostly banks, it is also called interbank call money market.

The banks with temporary deficit of funds form the demand side and the banks with temporary excess of funds form the supply side of the call money market.

**The main features of Indian call money market are as follows:**

(i) Call money market provides the institutional arrangement for making the temporary surplus of some banks available to other banks which are temporary in short of funds.

(ii) Mainly the banks participate in the call money market. The State Bank of India is always on the lenders’ side of the market.

(iii) The call money market operates through brokers who always keep in touch with banks and establish a link between the borrowing and lending banks.

(iv) The call money market is highly sensitive and competitive market. As such, it acts as the best indicator of the liquidity position of the organised money market.

(v) The rate of interest in the call money market is highly unstable. It quickly rises under the pressures of excess demand for funds and quickly falls under the pressures of excess supply of funds.

(vi) The call money market plays a vital role in removing the day-to-day fluctuations in the reserve position of the individual banks and improving the functioning of the banking system in the country.

**B. Treasury Bill Market:**

The treasury bill market deals in treasury bills which are the short-term (i.e., 91, 182 and 364 days) liability of the Government of India. Theoretically these bills are issued to meet the short-term financial requirements of the government.

But, in reality, they have become a permanent source of funds to the government. Every year, a portion of treasury bills are converted into long-term bonds. Treasury bills are of two types: ad hoc and regular.

Ad hoc treasury bills are issued to the state governments, semi- government departments and foreign central banks. They are not sold to the banks and the general public, and are not marketable.

The regular treasury bills are sold to the banks and public and are freely marketable. Both types of ad hoc and regular treasury bills are sold by Reserve Bank of India on behalf of the Central Government.

The treasury bill market in India is underdeveloped as compared to the treasury bill markets in the U.S.A. and the U.K.

**C. Commercial Bill Market:**

Commercial bill market deals in commercial bills issued by the firms engaged in business. These bills are generally of three months maturity. A commercial bill is a promise to pay a specified amount in a specified period by the buyer of goods to the seller of the goods. The seller, who has sold his goods on credit draws the bill and sends it to the buyer for acceptance. After the buyer or his bank writes the word ‘accepted’ on the bill, it becomes a marketable instrument and is sent to the seller.

The seller can now sell the bill (i.e., get it discounted) to his bank for cash. In times of financial crisis, the bank can sell the bills to other banks or get them rediscounted from the Reserved Bank. In India, the bill market is undeveloped as compared to the same in advanced countries like the U.K. There is absence of specialised institutions like acceptance houses and discount houses, particularly dealing in acceptance and discounting business.

**E. Certificate of Deposit and Commercial Paper Markets:**

Commercial paper is an unsecured, short-term debt instrument issued by corporations. It's typically used to the finance short-term liabilities such as payroll, [accounts payable](https://www.investopedia.com/terms/a/accountspayable.asp), and inventories. There are four types of commercial paper: promissory notes, drafts, checks, and [certificates of deposit](https://www.investopedia.com/terms/c/certificateofdeposit.asp) (CDs).

Certificate of Deposit (CD) and Commercial Paper (CP) markets deal with certificates of deposit and commercial papers. These two instruments (CD and CP) were introduced by Reserve Bank of India in March 1989 in order to widen the range of money market instruments and give investors greater flexibility in the deployment of their short-term surplus funds.

A certificate of deposit is exactly what the name implies: a bank receipt, or certificate, that asserts that the bank has received a sum of money deposited by an investor. It agrees to pay back this money plus interest at a specific time in the future. The CD also states the interest rate to be paid and the maturity date.

**F. REPO**

A repurchase agreement (repo) is a form of short-term borrowing for dealers in [government securities](https://www.investopedia.com/terms/g/governmentsecurity.asp). In the case of a repo, a dealer sells government securities to [investors](https://www.investopedia.com/terms/i/investor.asp), usually on an overnight basis, and buys them back the following day at a slightly higher price. That small difference in price is the implicit overnight interest rate. Repos are typically used to raise short-term [capital](https://www.investopedia.com/terms/c/capital.asp). They are also a common tool of central bank [open market operations](https://www.investopedia.com/terms/o/openmarketoperations.asp).

For the party selling the security and agreeing to repurchase it in the future, it is a repo; for the party on the other end of the transaction, buying the security and agreeing to sell in the future, it is a [reverse repurchase agreement](https://www.investopedia.com/terms/r/reverserepurchaseagreement.asp).

* A repurchase agreement, or "repo," is a short-term agreement to sell securities in order to buy them back at a slightly higher price.
* The one selling the repo is effectively borrowing and the other party is lending, since the lender is credited the implicit interest in the difference in prices from initiation to repurchase.
* Repos and reverse repos are thus used for short-term borrowing and lending, often with a tenor of overnight to 48 hours.
* The implicit interest rate on these agreements is known as the repo rate, a proxy for the overnight risk-free rate.

**Defects of Indian Money Market:**

The central bank controls and -regulates the money supply in the country through the money market. But, unfortunately, the Indian money market is inadequately developed, loosely organised and suffers from many weaknesses.

**Major defects are discussed below:**

**I. Dichotomy between Organised and Unorganised Sectors:**

The most important defect of the Indian money market is its division into two sectors- (a) the organised sector and (b) the unorganised sector. There is little contact, coordination and cooperation between the two sectors. In such conditions it is difficult for the Reserve Bank to ensure uniform and effective implementations of its monetary policy in both the sectors.

**II. Predominance of Unorganised Sector:**

Another important defect of the Indian money market is its predominance of unorganised sector. The indigenous bankers occupy a significant position in the money- lending business in the rural areas. These indigenous bankers, which constitute a large portion of the money market, remain outside the organised sector. Therefore, they seriously restrict the Reserve Bank’s control over the money market.

**III. Wasteful Competition:**

Wasteful competition exists not only between the organised and unorganised sectors, but also among the members of the two sectors. For example, even today, the State Bank of India and other commercial banks look down upon each other as rivals. Similarly, competition exists between the Indian commercial banks and foreign banks.

**IV. Absence of All-India Money Market:**

Indian money market has not been organised into a single integrated all-Indian market. It is divided into small segments mostly catering to the local financial needs.

**V. Inadequate Banking Facilities:**

Indian money market is inadequate to meet the financial need of the economy. Although there has been rapid expansion of bank branches in recent years particularly after the nationalisation of banks, yet vast rural areas still exist without banking facilities. As compared to the size and population of the country, the banking institutions are not enough.

**VI. Shortage of Capital:**

Indian money market generally suffers from the shortage of capital funds.

**Many factors are responsible for the underdeveloped bill market in India:**

(i) Most of the commercial transactions are made in terms of cash.

(ii) Cash credit is the main form of borrowing from the banks. Cash credit is given by the banks against the security of commodities. No bills are involved in this type of credit,

(iii) The practice of advancing loans by the sellers also limits the use of bills,

(iv) There is lack of uniformity in drawing bills (hundies) in different parts of the country,

(v) Heavy stamp duty discourages the use of exchange bills.

(vi) Absence of acceptance houses is another factor responsible for the underdevelopment of bill market in India.

(vii) In their desire to ensure greater liquidity and public confidence, the Indian banks prefer to invest their funds in first class government securities than in exchange bills,

(viii) The Reserve Bank of India also prefers to extend rediscounting facility to the commercial banks against approved securities.

**Measures to Improve Indian Money Market:**

**Suggestions to Remove Defects:**

(i) The activities of the indigenous banks should be brought under the effective control of the Reserve Bank of India.

(ii) Hundies used in the money market should be standardised and written in the uniform manner in order to develop an all-India money market,

(iii) Banking facilities should be expanded especially in the unbanked and neglected areas,

(iv) Discounting and rediscounting facilities should be expanded in a big way to develop the bill market in the country.

(v) For raising the efficiency of the money market, the number of the clearing houses in the country should be increased and their working improved.

(vi) Adequate and less costly remittance facilities should be provided to the businessmen to increase the mobility of capital.

(vii) Variations in the interest rates should be reduced.