

Money Market – Definition, Importance & Instruments

Definition of Money Market

- Money Market = Segment of the financial market where **short-term (≤ 1 year) high liquidity instruments** are traded.
- Deals in securities like:
 - Treasury Bills
 - Commercial Papers
 - Certificates of Deposit
 - Call Money

Features of Money Market

- Short maturity (1 day to 1 year)
- High liquidity
- Low risk
- Wholesale market (institutions dominate)
- No fixed physical location

Importance of Money Market

1. Development of Trade & Industry

- Provides short-term working capital
- CPs, bill discounting → quick funds

2. Development of Capital Market

- Short-term interest rates influence long-term rates
- Liquidity conditions affect investment climate

3. Smooth Functioning of Commercial Banks

- Banks park surplus funds
- Helps meet:
 - CRR
 - SLR
- Liquidity adjustment

4. Effective Central Bank Control

- Enables the **Reserve Bank of India** to implement monetary policy efficiently

5. Indicator of Monetary Conditions

- Call money rate and repo rate reflect liquidity conditions

6. Non-Inflationary Government Financing

- Govt raises funds via Treasury Bills
- Avoids deficit monetisation

Structure of Indian Money Market

A. Unorganised Money Market

- Indigenous bankers
- Moneylenders
- Chit funds
- Poor regulation

B. Organised Money Market

- Regulated by RBI
- Institutional participants

Major Money Market Instruments in India

Treasury Bills (T-Bills)

- Issued by the Central Government
- Maturity:
 - 91 days
 - 182 days
 - 364 days
- Zero-coupon (issued at a discount)
- Eligible for SLR

Used for short-term fiscal deficit financing

Certificates of Deposit (CDs)

- Introduced: 1989
- Issued by banks & financial institutions
- Negotiable
- Maturity:

- Banks: 7 days–1 year
- FIs: 1–3 years

Commercial Papers (CPs)

- Introduced: 1990
- Issued by corporate houses
- Unsecured promissory note
- Requires credit rating (CRISIL, ICRA etc.)
- Maturity: 7 days–1 year

Commercial Bills

- Used in trade financing
- Discounted by banks
- Replaced the old Bill Market scheme (1952)

Call Money Market

- Inter-bank overnight market
- Duration:
 - 1 day (Call money)
 - Up to 14 days (Notice money)
- Interest rate is closely linked with the **Repo Rate**

Participants:

- Borrowers & lenders: Scheduled Commercial Banks
- Only lenders: LIC, NABARD etc.

Money Market Mutual Funds (MMMFs)

- Introduced: 1992
- Short-term investment avenue
- Regulated by:
 - RBI (earlier)
 - Now, mainly **Securities and Exchange Board of India**

Repo & Reverse Repo

Under Liquidity Adjustment Facility (LAF):

Repo

- Banks borrow from the RBI

- Sell govt securities with a repurchase agreement

Reverse Repo

- RBI borrows from banks
- Absorbs liquidity

Key tool of monetary policy

Cash Management Bills (CMBs)

- Introduced: 2009
- Short-term (<91 days)
- Used for temporary cash mismatch
- Similar to T-bills
- Eligible for SLR

Comparison: Money Market vs Capital Market

Basis	Money Market	Capital Market
<i>Maturity</i>	≤ 1 year	> 1 year
<i>Risk</i>	Low	Higher
<i>Liquidity</i>	High	Moderate
<i>Instruments</i>	T-bills, CP, CD	Shares, Bonds

Monetary Policy Linkages

- Repo rate affects the call money rate
- Liquidity deficit/surplus is visible in the money market
- Important for inflation control