Money Market in India

The Money Market is a very important segment of the Indian financial system. It is the market where short term monetary assets are dealt in to raise short term requirements of funds and/ or to park short term surpluses. The main characteristic of the Money Market is the liquid nature.

The money market transactions may range from overnight to one year. It has minimum transaction cost. This unit encompass the structure of the Money Market that has undergone vast changes in the last decade. In this unit, we are going to discuss the different instruments and the defect of Indian Money Market. The unit also discuss the bill market. Thus, you will be able to understand through this unit the structure, instrument as well as the defect of the Indian money market.

The money market is the market which deals with short term funds in the economy. It refers to the institutional arrangements facilitating borrowings and lending of short term funds.

Participants of money market:

Following are the institutions which can take part in money market:

- Central and State Government
- Public sector undertaking
- Private sector companies
- Non-banking financial institutions
- Mutual funds
- Insurance companies
- Primary dealers

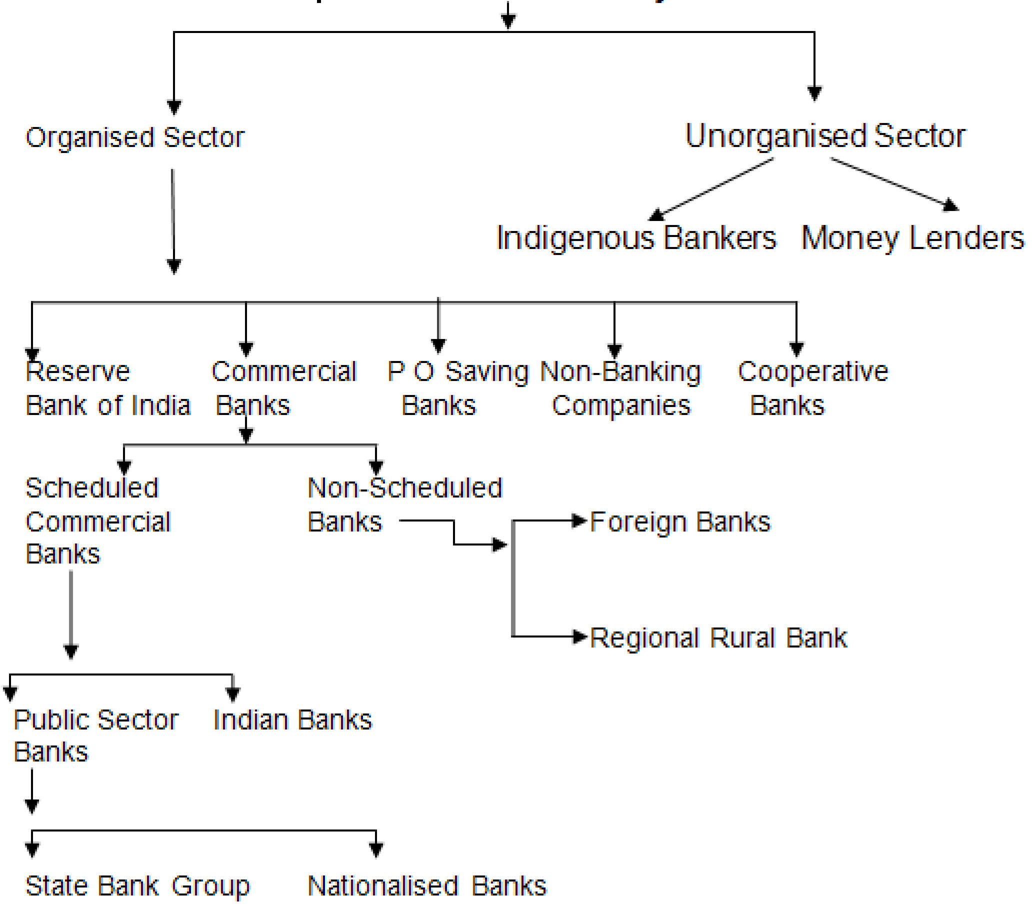
BASIC FUNCTIONS OF MONEY MARKET:

1. To provide efficient mechanism of liquidating for commercial banks, non-banking financial institutions, business firms and other investors.
2. To bridge between short term surpluses and defects.
3. To provide a realistic price for short term money.
4. To provide a platform for the Central bank of the country to control and manage the money supply.

STRUCTURE OF INDIAN MONEY MARKET

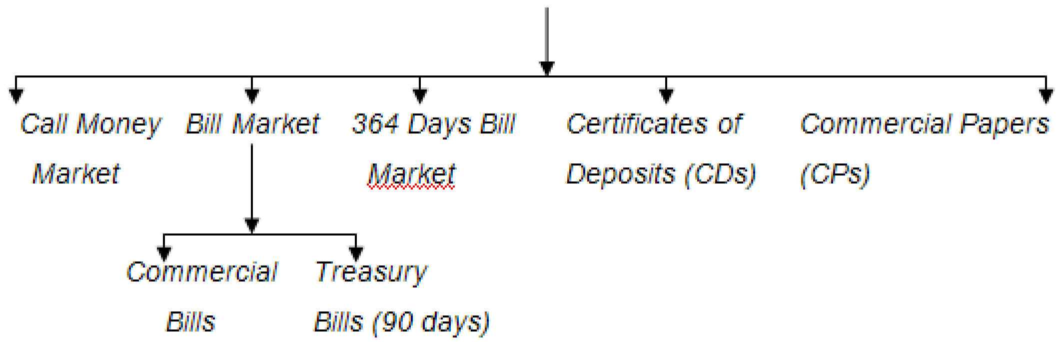
The Money Market is the close substitutes for money with the short term time span from overnight to year. The Indian Money Market consists of both organised and unorganised segment. The organised segment includes the Reserve Bank of India, State Bank of India, Public Sector as well as Private Sector Banks, Regional Rural Bank, Commercial Banks including Foreign Banks, Non-Scheduled Commercial Banks and other Non-Bank Financial Intermediaries such as LIC, GIC, and UTI etc. On the other hand, the unorganised segment consists of indigenous bankers, money lenders and other non-bank financial intermediaries.

Structure of Indian Money Market



Indian money market can be divided into various sub-markets depending on their nature and scope of the transactions and the features of the instruments.

SUB MARKETS OF MONEY MARKET



Money Market instruments mainly include Government securities, securities issued by private sector and banking institutions—

1. Government Securities
2. Money at Call and Short Notice
3. Bills Rediscounting
4. Inter-Bank Participation
5. Money Market Mutual Funds

6. Call Money Market and Short-term Deposit Market
7. Treasury Bills
8. Certificates of Deposits
9. Inter-Corporate Deposits
10. Commercial Bills
11. Commercial Paper
12. Gilt-edged (Government) Securities
13. Repo Market

1. Government Securities: The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills. The different types of Government Securities are—

I. Dated Securities
II. Zero Coupon Bonds
III. Partly Paid Stock
IV. Floating Rate Bonds
V. Bonds with Call/ Put Option
VI. Capital Indexed Bonds

The Government dated securities can be purchased for a minimum amount of Rs. 10,000/- and the Treasury bills of Rs. 25,000/- and in multiple thereof. The State Government Securities can be purchased for a minimum amount of Rs.1, 000/-.

2. Money at Call and Short Notice: Call money or call deposits are that money which is lent on condition to repay on call. Notice money refers to the money lent and repaid on a certain day's notice from the lenders. Banks borrow for a variety of reasons to maintain their cash reserve ratio, heavy payments, to maturity mismatch etc. Money at short notice is for a maturity upto 14 days. The main participants are banks and all India financial institutions as permitted by RBI.

A minimum size of Rs. 20 crores for each transaction was permitting the participation of the corporate in the call money market. The Discount and Finance House of India (DFHI) enhanced the activity of Call Money Market and Short-term Deposit Market. It allows lending and borrowing of funds.

The borrowers are essentially the banks. It can operate outside the purview of the provision of the ceiling rates fixed by the Indian Banks Association. The different participants that lend fund in the market are like GIC, IDBI, NABARD etc. The private Mutual funds were also participating in the market. The DFHI ascertains the settlement between the lender and the borrower about the availability of fund and the amount needed and the exchanges. It also provides advice regarding the interest rates applicable to them.

Here, the call rates are more volatile as they are determined by the interaction of demand and supply of funds in the market which is based on the maintenance of Cash Reserve Ratio by the banks. There are two call rates maintained in India i.e. Inter-bank call rate and the lending rate of DFHI.

3. Bills Rediscounting Scheme: This is a money market scheme whereby banks may raise funds by issue of usance from issuing notes in convenient lots and maturities matching the genuine trade bills discounted by them. This instrument promotes liquidity in the market. Here the seller draws a bill of exchange and the buyer accepts it. Suppose, When X sells on credit and X (seller) needs money in the meantime, it may approach to the bank for discounting the bill and the seller get the money.

Now, the bank which has discounted the bill may require getting it 'rediscounted' with some other bank to get the fund. This is called 'bill rediscounting'. The bank has a facility to rediscount the bills with the RBI and other approved institutions like LIC, GIC, UTI, ICICI etc

4. Inter-Bank Participation Certificate: Inter-Bank Participation Certificates are instruments issued by scheduled commercial banks only to raise funds or to deploy short term surplus. This instrument is issued as per RBI guidelines for two purposes:

a. on risk sharing basis
b. without risk sharing

Inter-Bank Participation without risk sharing can have tenure of 90 days only where, the issuing bank as borrowing and the participating bank advances to the banks. In case of risk sharing basis, the lender bank shares losses with the borrowing banks by mutually determining the interest rate. The tenure may be for 90 to 180 days.

5. Money Market Mutual Funds (MMMFs):

To provide safety, liquidity and return, MMMFs are formed which collect the small savings of a large number of savers and invest them in the capital market. This concept is extended to money market. Hence, the concept of money market mutual funds has coming up. The SEBI revises the guidelines on MMMFs from time to time relating to maximum limit of investment.

6. Treasury Bills: Treasury Bills are discounted securities issued at a discount face value as per the short term requirement of the Government of India. RBI issues Treasury Bills on a prefixed day and at a fixed amount. There are four types of Treasury Bills:

a. 14-day Tbill maturity is in 14 days.
b. 91-day Tbill maturity is in 91 days.
c. 182-day Tbill maturity is in 182 days.
d. 364-day Tbill maturity is in 354 days.

These are highly liquid money market instruments. It is a zero default risk bearing paper. It helps in deployment of idle funds for very shorts periods as well.

7. Certificates of Deposits:

These are issued according to the guidelines of the Reserve Bank of India in dematerialized form or Usance Promissory Note for the fund deposited at a bank or other financial institution. It is a negotiable money market instrument whose minimum deposit should be Rs.1 lakh and the multiples of Rs. 1 lkh thereafter. The maturity period of Certificates of Deposits should not be less than 15 days and not more than 1 year. But, it should not be less than 1 year and exceed 3 years for financial institution.

8. Inter-Corporate Deposits:

Inter-Corporate Deposits are unsecured loan extended by one corporate to another. As the cost of funds for a corporate is higher than a bank, the rates in this market are higher than those in the other market.

9. Commercial Bills:

These are the bills accepted by the buyer for goods and services on credit from the seller and which may be kept upto the due date and encased by the seller or may be endorsed to a third party. The bills being bills of exchange may be discounted with the banks or financial institutions. These bills may again be the rediscounted at the bank.

10. Commercial Papers (CP):

It is an additional unsecured money market instrument to the investors as a source of short term borrowing. This instrument is issued in the form of a promissory note or dematerialized form. Every issuer has to appoint an Issuing and Paying Agent (IPA) for the issue of commercial papers and only a scheduled bank can act as an IPA for issuance of CP. The investor are given the Issuing and Paying Agent (IPA) certificate as well as issued physical certificates or arrangement is made for crediting the CP to the investor's account with a depository. The CP issued for a maturity period between a minimum of 7 days and a maximum up to one year from the date of issue in the denomination of Rs. 5 lakh or multiples thereof. The main purposes of introducing CP are—

- To enable the high level corporate borrowers such as leasing and financing of companies, manufacturing and financial institutions etc.
- To diversify the sources of short term borrowing
- To provide instrument for bank and financial institution in the money market.

11. Gilt-edged (Government) Securities:

Gilt-edged (Government) Securities have great demand by the banks to maintain the Net Demand and Time Liquidities (NDTL) position of the bank through its buying and selling. These securities are issued by Governments such as Central and State Governments, Semi-Government Authorities, Municipalities etc. They are long dated securities and held by the RBI. These issues are notified a few days before opening for subscription and offer is kept open for two to three days. The rate of interest is lower but it is payable half yearly.

12. Repo Market:

This money market instrument helps in collateralised short- term borrowing and lending through sale or purchase operation in debt instruments. Here the securities are sold by the holders to the investors with an agreement to repurchase them at a predetermined rate and date.

On the other hand, under the reverse repo transactions, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date.

Bill Market

A bill is nothing but a promise by the borrower to the creditor to pay. These bills should be drawn on and accepted by the purchaser's bank. The date of repayment of bank's loan is fixed. It is of three types: i.) promissory notes, ii.) bills of exchange, and iii.) treasury bills. This is a market of short term bill to meet short term financial needs of individual, companies etc.

The commercial banks use these bills to maintain their financial positions of the bank by disposing or rediscounting it in the Reserve Bank of India. The Reserve bank of India has been making efforts to develop the bill market. These are of self- liquidating nature. Now-a-days, all commercial banks as well as the public sector banks are eligible for to offer the bill of exchange for rediscounting to the Reserve Bank of India.

Key points to remember:

1. Money Market is a market for short term funds. Money is raised and deployed for short term in this market.
2. The Money Market is the close substitutes for money with the short term upto one year.
3. A minimum size of Rs. 20 crores for each transaction was permitted in the participation of the corporate in the call money market.
4. The maturity period of Certificates of Deposits should not be less than 15 days and not more than 1 year.
5. On the recommendation of the Sukhmoy Chakravarty Committee and the Narasimham committee, RBI initiated a series of reform in Indian Money Market.
6. To provide safety, liquidity and return, MMMFs are formed which collect the small savings of a large number of savers and invest them in the capital market.
7. Gilt-edged (Government) Securities security have great demand for the banks to maintain the Net Demand and Time Liquidities (NDTL) position of the bank through its buying and selling.
8. Under the reverse repo transactions, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date.