

UNIT-II CHAPTER 6

MONEY MARKET

INTRODUCTION

Money Market is a segment of financial markets where financial instruments having maturities of less than one year are traded. Examples of money markets are Treasury Bills, Commercial Bills, and Certificate of Deposits, Government Securities etc. It is a market for purely short-term funds. This chapter deals with the features of money market and the instruments of money market. It also helps to identify the differences between money market and capital market.

I. CHOOSE THE CORRECT ANSWERS

- The money invested in the call money market provides high liquidity with _____**
a) Low Profitability b) High Profitability
c) Limited Profitability d) Medium Profitability
- A major player in the money market is the _____**
a) Commercial Bank b) Reserve Bank of India
c) State Bank of India d) Central Bank
- Money Market Provides _____**
a) Medium-term Funds b) Short-term Funds
c) Long-term Funds d) Shares
- Money Market Institutions are _____**
a) Investment Houses
b) Mortgage Banks
c) Reserve Bank of India
d) Commercial Banks and Discount Houses.
- Risk in the Money Market is _____**
a) High b) Market Risk
c) Low Credit and Market Risk d) Medium Risk
- Debt Instruments are issued by Corporate Houses are raising short-term financial resources from the money market are called _____**
a) Treasury Bills
b) Commercial Paper
c) Certificate of Deposit
d) Government securities

7. The market for buying and selling of Commercial Bills of Exchange is known as _____

- Commercial Paper Market
- Treasury Bill Market
- Commercial Bill Market
- Capital Market

8. A marketable document of title to a time deposit for a specified period may be referred to as a _____

- Treasury Bill
- Certificate of Deposit
- Commercial Bill
- Government Securities

9. Treasury Bills commands _____

- High Liquidity
- Low Liquidity
- Medium Liquidity
- Limited Liquidity

10. Government securities are issued by agencies such as _____

- Central Government
- State Government
- Semi- Government Authorities
- All of the above

ANSWERS

| | | | | | | | | | |
|---|----|---|----|---|----|---|----|----|----|
| 1 | a) | 2 | a) | 3 | b) | 4 | d) | 5 | c) |
| 6 | b) | 7 | c) | 8 | b) | 9 | a) | 10 | d |

II. VERY SHORT ANSWER QUESTIONS:

1. Define the term "Money Market".

The RBI defines the money market as, "a market for short-term financial assets that are close

substitutes for money facilitates the exchange of money for new financial claims in the primary market as also for financial claims, already issued, in the secondary market”.

2. What is commercial bill market?

- ❖ A Commercial bill is one which arises out of a genuine trade transaction, i.e credit transaction.
- ❖ As soon as goods are sold on credit, the seller draws a bill on the buyer for the amount due.
- ❖ The buyer accepts it immediately agreeing to pay amount mentioned therein after a certain specified date.

3. What is a CD market?

- ❖ Certificate of Deposits are short-term deposit instruments issued by banks and financial institutions to raise large sums of money.
- ❖ Certificate of Deposits are issued in the form of usance promissory notes.
- ❖ The Certificate of Deposit is transferable from one party to another.
- ❖ Due to their negotiable feature, they are also known as negotiable certificate of deposit.
- ❖ The Issuers of Certificate of Deposits are Commercial Banks, Financial Institutions, etc.,

4. What is Government Securities Market?

A market whereby the Government or gilt-edged securities can be bought and sold is called 'Government Securities Market'.

5. What are the Instruments of money market?

- ❖ Treasury Bills in the Treasury Market
- ❖ Money at Call and Short Notice in the Call Loan Market
- ❖ Commercial Bills and Promissory Notes in the Bill Market

6. Explain the two oldest money markets.

The following are the two oldest money markets.

- ❖ Treasury Bill Market: A Market for the purchase and sale of Treasury Bills is known as a "Treasury Bills Market".
- ❖ Commercial Bill : The Commercial Bill is an instrument drawn by a seller of goods on a buyer of goods. These bills are of 30 days;60 days and 90 days maturity.

7. What do you meant by Auctioning?

A method of trading whereby merchants bid against one another and where the securities are sold to the highest bidder is known as 'auctioning'.

8. What do you meant by Switching?

The purchase of one security against the sale of another security carried out by the RBI in the secondary market as part of its open market operations is described as 'Switching'.

III. SHORT ANSWER QUESTIONS:

1. What are the features of Treasury Bills?

Treasury Bills incorporate the following general features.

1. Issuer
2. Finance Bills
3. Liquidity
4. Vital Source
5. Monetary Management

2. Who are the participants of Money Market?

There are many participants operating in the Money Market. The participants deal with the money market instruments like Treasury Bills, Commercial Bills, Commercial Papers, etc.,

1. Government of different countries
2. Central Banks of different countries
3. Private and Public Banks
4. Mutual Funds Institutions
5. Insurance Companies
6. Non-Banking Financial Institutions
7. RBI and SBI
8. Commercial Banks
9. State Governments
10. Public

3. Explain the types of Treasury Bills?

- ❖ Treasury Bills are issued to the public and other financial institutions for meeting the short-term financial requirements of the Central Government.
- ❖ These bills are freely marketable and they can be bought and sold at any time and these bill are tradable in secondary market as well.
- ❖ On the basis of periodicity, Treasury Bills may be classified into three. They are:

1) 91 days Treasury Bills - issued at a fixed discount rate of 4 per cent as well as through auctions

2) 182 days Treasury Bills - The RBI holds 91 days and 182 Treasury Bills and they are issued on tap basis throughout the week

3) 364 days Treasury Bills - Do not carry any fixed rate. The discount rate on these bills are quoted in auction by the participants and accepted by the authorities. This rate is known as cut off rate.

4. What are the features of Certificate of Deposit?

The following are the features of Certificate of Deposit:

1. Document of title to time deposit
2. It is unsecured negotiable instruments.
3. It is freely transferable by endorsement and delivery.
4. It is issued at discount to face value.
5. It is repayable on a fixed date without grace days

5. What are the types of Commercial Bill?

The following are the types of Commercial Bill:

a. Demand and Usance Bills

A demand bill is one wherein no specific time of payment is mentioned. So, demand bills are payable immediately when they are presented to the drawee.

b. Clean bills and documentary Bills

Bills that are accompanied by documents of title to goods are called documentary bills. Clean bills are drawn without accompanying any document.

E.g. Railway Receipt and Lorry Receipt

c. Inland bills and Foreign Bills

Bills that are drawn and payable in India on a person who is resident in India are called inland bills. Bills that are drawn outside India and are payable either in India or outside India are called foreign bills.

d. Indigeneous Bills

The drawing and acceptance of indigenous bills are governed by native custom or usage of trade.

e. Accommodation and supply Bills

Accommodation bills are those which do not arise out of genuine trade of transactions.

IV. LONG ANSWER QUESTIONS:

1. Define Money Market and Capital Market. Explain the difference between the money market and Capital Market.

Definition:

| Money Market | Capital Market |
|--|---|
| The RBI defines the money market as, "a market for short-term financial assets that are close substitutes for money facilitates the exchange of money for new financial claims in the primary market as also for financial claims, already issued, in the secondary market". | According to Arun K. Datta, capital market may be defined as "a complex of institutions investment and practices with established links between the demand for and supply of different types of capital gains". |

| Sl. no | Differences | Money Market | Capital Market |
|--------|------------------------|---|---|
| 1. | Duration of Funds | It is a market for short term loanable funds for a period of not exceeding one year | It is a market for loanable funds exceeding period of one year |
| 2. | Supply of funds | Supplies fund for financing current business operations working capital requirements of industries and short period requirements of the government. | Supplies fund for financing the fixed capital requirements of trade and commerce as well as the long term requirements of the government. |
| 3. | Deals with Instruments | It deals with instruments like commercial bills | It deals with instruments like shares, debentures, Government bonds etc |

| | | | |
|-----|-----------------------------|--|--|
| 4. | Availability of Instruments | Money Market instruments generally do not have secondary market | Capital market instruments generally have secondary markets. |
| 5. | Subdivision | In money market there is no such subdivision | In Capital market there is a division of primary market and secondary market. |
| 6. | Place of Transaction | Transactions mostly take place over the phone and there is no formal place | Transactions take place at a formal place.Eg.Stock Exchange |
| 7. | Participants | Transactions have to be conducted without the help of brokers i.e., Bankers,RBI and Governemnt | Transactions have to be conducted only through authorized dealers.ie. Brokers, Investors, Merchant Bankers, Underwriters and Commercial Banks. |
| 8. | Claims | Financial claims, assets and securities are dealt in the money market | Bonds and shares are dealt in the capital market |
| 9. | Risk | Low credit and market risk | High credit and market risk |
| 10. | Liquidity | High liquidity in money market. | Low liquidity in capital market. |

2. Explain the characteristics of Money Market?

The following are features of Money Market.

1. Short-term Funds

It is a market purely for short-term funds or financial assets called near money.

2. Maturity Period

It deals with financial assets having a maturity period upto one year only.

3. Conversion of Cash

It deals with only those assets which can be converted into cash readily without loss and with minimum transaction cost.

4. No Formal Place

Generally, transactions take place through phone, i.e., oral communication. Relevant documents and written communications can be exchanged subsequently. There is no formal place like stock exchange as in the case of a capital market.

5. Sub-markets

It is not a single homogeneous market. It comprises of several sub-markets each specialising in a particular type of financing. E.g., Call Money Market, Acceptance Market,Bill Market.

6. Role of Market

The components of a money market are the Central Bank, Commercial Banks, Non-Banking Financial Companies, Discount Houses and Acceptance House. Commercial banks generally play a dominant role in this market.

7. Highly Organized Banking System

The Commercial Banks are the nerve centre of the whole money market. They are the principal suppliers of short-term funds. The commercial banks serve as vital link between the Central Bank and the various segments of the money market.

8. Existence of Secondary Market

There should be an active secondary market for these instruments.

9. Demand and Supply of Funds

There should be a large demand and supply of short-term funds. It presupposes the existence of a large domestic and foreign trade.

10. Wholesale Market

It is a wholesale market and the volume of funds or financial assets traded in the market is very large.

11.Flexibility

Due to greater flexibility in the regulatory framework, there are constant endeavours for introducing new instruments.

12. Presence of a Central Bank

The central bank keeps their cash reserves and provides them financial accommodation in difficulties by discounting their eligible securities. Through its open market operations the central bank absorbs surplus cash during off-seasons and provides additional liquidity in the busy seasons.

3. Explain the Instruments of Money Market?

There are many kinds of Instruments available in Money Market. In India, till 1986, only a few instruments were available. They were as follows:

- i. Treasury Bills in the Treasury Market
- ii. Money at Call and Short Notice in the Call Loan Market
- iii. Commercial Bills and Promissory Notes in the Bill Market

Now in addition to the above, the following new instruments come into existence:

- i. Commercial Papers
- ii. Certificate of Deposits
- iii. Inter-Bank participation Certificates.
- iv. Repo Instruments.

4. Explain the features and types of Commercial Bills?

The features of the Commercial Bills are as follows:

1. Drawer
2. Acceptor
3. Payee
4. Discounter
5. Endorser
6. Assessment
7. Maturity
8. Credit Rating

The following are the types of Commercial Bill:

a. Demand and Usance Bills

A demand bill is one wherein no specific time of payment is mentioned. So, demand bills are payable immediately when they are presented to the drawee.

b. Clean bills and documentary Bills

Bills that are accompanied by documents of title to goods are called documentary bills. Clean bills are drawn without accompanying any document. E.g. Railway Receipt and Lorry Receipt

c. Inland bills and Foreign Bills

Bills that are drawn and payable in India on a person who is resident in India are called inland bills. Bills that are drawn outside India and are payable either in India or outside India are called foreign bills.

d. Indigenous Bills

The drawing and acceptance of indigenous bills are governed by native custom or usage of trade.

e. Accommodation and supply Bills

Accommodation bills are those which do not arise out of genuine trade of transactions.

5. What are the features of Government Securities?**Characteristics /Features:**

Government Securities plays a significant role in the Indian Money Market. The characteristics of Government Securities are discussed below:

1. Agencies

Government securities are issued by agencies such as Central Government, State Governments, semi-government authorities like local Government authorities, e.g. municipalities, autonomous institution such as metropolitan authorities, port trusts etc.,

2. RBI Special Role

RBI takes a special and an active role in the purchase and sale of these securities as part of its monetary management exercise.

3. Nature of Securities

Securities offer a safe avenue of investment through guaranteed payment of interest and repayment of principal by the Government.

4. Liquidity Profile

The liquidity profile of gilt-edged securities varies. Accordingly liquidity profile of securities issued by Central Government is high.

5. Tax Rebate

A striking feature of these securities is that they offer wide-range of tax incentives to investors.

This has made these securities very popular for this benefit.

6. Market

As each sale and purchase has to be negotiated separately, the Gilt-Edged Market is an Over-The-Counter Market. The Government securities market in India has two segments namely primary market and secondary market.

7. Forms

The securities of Central and State Government take such forms as inscribed stock or stock certificate, promissory note and bearer bond.

8. Participants

The participants in Government securities market include the Government sector comprising Central and State Governments whose holdings represent governmental transfer of resources.

9. Trading

Although the secondary market for Government securities is narrow, small and less active, banks and corporate holders who purchase and sell Government securities on the stock exchanges participate in trading.

10. Issue Mechanism

The Public Debt Office (PDO) of the RBI undertakes to issue government securities.

11. Issue opening

A notification for the issue of the securities is made a few days before the public subscription is open.

12. Grooming Gradual

Acquisition of securities nearing maturity through the stock exchanges by the RBI in order to facilitate redemption is described as 'grooming'.

13. Switching

The purchase of one security against the sale of another security carried out by the RBI in the secondary market as part of its open market operations is described as 'Switching'.

13. Auctioning

A method of trading whereby merchants bid against one another and where the securities are sold to the highest bidder is known as 'auctioning'.

ADDITIONAL QUESTIONS:

I. CHOOSE THE CORRECT ANSWERS:

- Commercial paper issued with low interest rate thus commercial paper is categorized as _____.**
a) Payables rating b) Commercial rating
c) Poor Credit Rating d) Better Credit rating
- Maximum maturity days of holding commercial paper are _____**
a) 180 days b) 91 days
c) 270 days d) None of the above
- Which of the following is a sub-market?**
a) Acceptance Market b) Cash Market
c) Primary Market d) None
- Which of the following are the issuers of Certificate of Deposits?**
a) Commercial Banks b) Financial Institutions
c) Both (a) & (b) d) None
- A Bill wherein no specific time of payment is mentioned is known as _____.**
a) Indigenous Bill b) Clean Bill
c) Demand Bill d) Post Dated Bill
- Assertion (A): Variance analysis is undertaken for planning and control of costs.**
Reason (R): Future costs are taken into consideration in budgeting and standard costing.
In the above statements, which one alternative of the following is correct?
Codes:
(A) Both (A) and (R) are correct and (R) is the Reason for (A).
(B) Both (A) and (R) are correct and (R) is not the Reason for (A).
(C) (A) is correct, but (R) is wrong.
(D) (A) is wrong, but (R) is correct.

- 7. Assertion (A):** The focus of working capital management revolves around managing the operating cycle of the working capital.
Reason (R): It is because the concept is useful to ascertain the requirements of cash to meet the operating expenses of a going concern.

Codes:

- (A) Both (A) and (R) are true, but (R) is not the explanation of working capital management.
 (B) Both (A) and (R) are false.
 (C) (A) is true, but (R) is false.
 (D) (A) is false, but (R) is true.

- 8. Assertion (A):** Treasury bills are issued to the public and other financial institutions for meeting the short-term financial requirements.

Reason (R): Treasury bills are freely marketable and they can be bought and sold at any time.

- (A) (A) is true but (R) is false
 (B) (A) is false but (R) is true
 (C) (A) and (R) are correct and (R) is correct explanation of (A).
 (D) Both (A) and (R) are correct, but (R) is not the correct explanation of (A).

- 9. Assertion(A):** Bills that are drawn outside India and are payable either in India or outside India are called Foreign Bills.

Reason(R) : In case of foreign bills the Indian company always bears the loss of bank charges.

- (A) (A) is true but (R) is false
 (B) (A) is false but (R) is true
 (C) (A) and (R) are correct and (R) is correct explanation of (A).
 (D) Both (A) and (R) are correct, but (R) is not the correct explanation of (A).

- 10. Assertion (A):** Accounting information refers to only events which are concerned with business firm.

Reason (R): Accounting information is presented in financial statements.

Codes:

- (A) (A) is correct, but (R) is wrong.
 (B) Both (A) and (R) are correct.

- (C) (A) is wrong, but (R) is correct.
 (D) Both (A) and (R) are wrong

| ANSWERS | | | | | | | | | |
|---------|----|---|----|---|----|---|----|----|----|
| 1 | d) | 2 | c) | 3 | a) | 4 | c) | 5 | c) |
| 6 | b) | 7 | a) | 8 | c) | 9 | d) | 10 | b) |

II. VERY SHORT ANSWER QUESTIONS:

1. What is clean bill?

Bills that are accompanied by documents of title to goods are called documentary bills. Clean bills are drawn without accompanying any document. E.g Railway Receipt and Lorry Receipt.

2. What is meant by Grooming Gradual in money market?

Acquisition of securities nearing maturity through the stock exchanges by the RBI in order to facilitate redemption is described as grooming gradual in money market.

OWN THINKING

1. If you earn money, which investment plan would you like?

1. Mutual Funds
 2. Shares
 3. Debentures
 4. Treasury Bill
 5. Commercial Bill
 6. Certificate of Deposit
- Why? Give reasons.

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