Examrace

Capital Market and Money Market (Part – 2) : Components of Money Market

Topics to be Covered Are

Part - 1

- What is Financial Market
- Classification of Financial Market (Capital Market & Money Market)
- Components of Capital Market
  - Primary Market
  - Secondary Market
- Difference between Primary and Secondary market

Part - 2

- Money Market
- Components of Money market
  - Treasury Bills (T- Bills)
  - Certificate of Deposits (CDs)
  - Commercial Papers (CPs)
  - Repurchase Agreements (Repo)
  - Call/Notice Money/Term Money
  - Banker's Acceptance (BA)

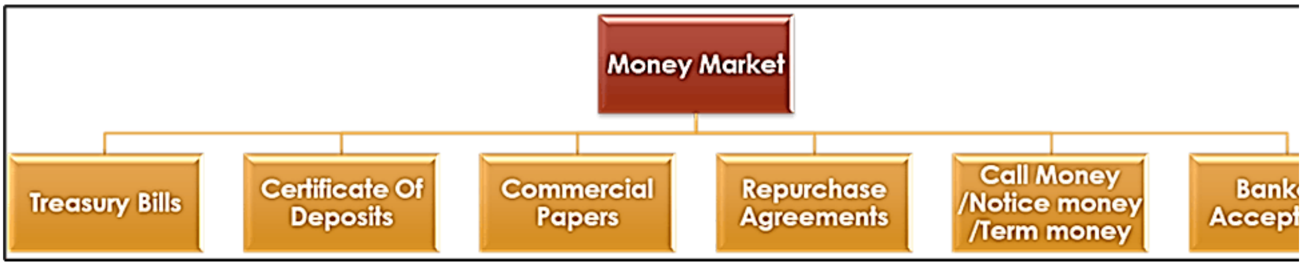
Money Market

Money Market: Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Over-the-counter trading is done in the money market and it is a wholesale process. It is used by the participants as a way of borrowing and lending for the short term.

Following are the objectives of served by a money market:

- The money markets help in lowering short term deficits.
- Helps the central bank in regulating liquidity in the economy.
- Assists the short-term fund users to fulfill their needs at a very reasonable rate.
- Contributes to the economic stability and development of a country by providing short – term liquidity to governments, commercial banks, and large organizations.
- Help in designing effective monetary policies.
- It also facilitates in streamlined functioning of commercial banks.

Components of Money Market



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Treasury Bills (T- Bills)

- The Treasury bills are issued by the Central Government.
- They carry zero risk.
- The returns are not attractive.
- They come with different maturity periods like 1 year, 6 months or 3 months.
- The central government issues them at a lesser price than their face-value.
- There are three types of treasury bills issued by the Government of India currently that is through auctions which are 91-day, 182-day and 364-day treasury bills.

Certificate of Deposits (CDs)

- Regulated by the Reserve Bank of India, a Certificate of Deposit is a type of money market instrument issued against the funds deposited by an investor with a bank in a dematerialized form for a specific period.
- Certificate of deposit is like a promissory note issued by a bank in form of a certificate authorizing the bearer to receive interest. It is like bank term deposit account. The certificate bears the maturity the maturity date, fixed rate of interest and the value. A Certificate of Deposit issued by the commercial banks can have a maturity period ranging from 7 days to 1 year. For financial institutions, it ranges from 1 year to 3 years.

Features of Certificate of Deposit

- **Eligibility**: There are certain conditions laid down by the RBI that allow the purchase of CDs.
- **Maturity Period**: A Certificate of Deposit issued by the commercial banks can have a maturity period ranging from 7 days to 1 year. For financial institutions, it ranges from 1 year to 3 years.
- **Minimum investment amount**: A CD can be issued to a single issuer for a minimum of ₹ 1 Lakh and its multiples.
- **Transferability**: Certificates that are available in Demat forms must be transferred according to the guidelines followed by Demat securities. While dematerialized/electronic certificates can be transferred by endorsement or delivery.
- **Discount offered**: Certificate of deposit is issued at a discounted rate on the face value.
- **Non-availability of loan**: Since these instruments do not have any lock-in period, banks do not grant loans against them.

Commercial Papers (CPs)

- CPs was introduced in India in 1990.
- Commercial papers can be compared to an unsecured short-term promissory note which is issued by top rated companies with a purpose of raising capital to meet requirements directly from the market.
- They usually have a fixed maturity period which can range anywhere from 1 day up to 270 days.
- They offer higher returns as compared to treasury bills. They are automatically not as secure in comparison. Also, Commercial papers are traded actively in secondary market

Repurchase Agreements (Repo)

- Repos are also known as Reverse Repo or as Repo. They are loans of short duration which are agreed by buyers and sellers for the purpose of selling and repurchasing.
- However, these transactions can be carried out between RBI approved parties.

- **Note**: Transactions can only be permitted between securities approved by RBI like the central or state government securities, treasury bills, central or state government securities, and PSU bonds.

Call Money/Notice Money/Term Money

With respect to Call Money, the funds are borrowed and lent for one day, whereas in the Notice Market, they are borrowed and lent up to 14 days, and term money is for more than 14 days without any collateral security.

Banker's Acceptance (BA)

- A Banker's Acceptance is a document that promises future payment which is guaranteed by a commercial bank. Also, it is used in money market funds and will specify the details of repayment like the date of repayment, amount to be paid, and details of the individual to which the repayment is due.
- BA's features maturity periods that range between 30 days up to 180 days.

#capitalmarketandmoneymarket #moneymarket #componentsofmoneymarket #treasurybills #certificateofdeposits #commercialpapers #repurchaseagreements #callmoney #noticemoney #termmoney #bankersacceptance

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