

Money Market

Definition:

The money market is a segment of the financial market where short-term borrowing and lending of funds occur. It deals with financial instruments that have high liquidity and short maturities, typically up to one year.

Role of Money Market:

1. **Liquidity Management:** Provides a mechanism for institutions to manage short-term cash needs and invest excess funds.
2. **Interest Rate Control:** Helps central banks implement monetary policy by influencing short-term interest rates.
3. **Safe Investment:** Offers low-risk, short-term investment options for investors.
4. **Funding for Businesses:** Provides companies with short-term financing to meet operational needs.
5. **Economic Stability:** Contributes to overall economic stability by facilitating efficient fund allocation and liquidity.

Money Market Instruments

Money market instruments are short-term financial products used for borrowing and lending within a short duration, typically less than one year. Here's a simple explanation of some key instruments:

1. Treasury Bills (T-Bills):

- **What Are They?** Short-term government securities issued by the government to raise funds.
- **How They Work:** T-Bills are sold at a discount and redeemed at face value upon maturity. The difference between the purchase price and face value is the interest earned by the investor.
- **Typical Maturity:** 91 days, 182 days, or 364 days.
- **Use:** They are considered one of the safest investments as they are backed by the government.

2. Certificates of Deposit (CDs):

- **What Are They?** Time deposits issued by banks and financial institutions.
- **How They Work:** Investors deposit money with the bank for a fixed term, earning a specified interest rate. The money can't be withdrawn until the term ends without incurring a penalty.
- **Typical Maturity:** Usually ranges from 3 months to 1 year.



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o **Use:** Used by banks to raise short-term funds, and by investors to earn higher interest rates than regular savings accounts.

3. **Commercial Paper:**

- o **What Is It?** An unsecured short-term debt instrument issued by large corporations.
- o **How It Works:** Companies issue commercial paper to finance their short-term obligations, like inventory or payroll. It's sold at a discount and redeemed at face value.
- o **Typical Maturity:** Typically 1 to 270 days.
- o **Use:** Provides companies with quick access to funds at lower interest rates than bank loans.

4. **Repurchase Agreements (Repos):**

- o **What Are They?** Short-term loans where one party sells securities to another with an agreement to repurchase them at a higher price on a specified date.
- o **How They Work:** The seller receives cash for the securities and agrees to buy them back later at a higher price, effectively paying interest.
- o **Typical Maturity:** Usually overnight but can extend to a few days.
- o **Use:** Used by institutions to manage short-term liquidity needs, often by banks and financial institutions.

5. **Interbank Loans:**

- o **What Are They?** Short-term loans made between banks to manage liquidity and meet reserve requirements.
- o **How They Work:** One bank lends money to another, usually overnight, at an interest rate known as the interbank rate.
- o **Typical Maturity:** Often overnight, but can extend up to a week.
- o **Use:** Helps banks manage their short-term liquidity requirements, ensuring they have enough funds to meet daily obligations.

These instruments play a crucial role in the functioning of the money market, providing liquidity, financing, and investment opportunities, while also aiding central banks in implementing monetary policy.

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