CHALLENGES FOR MONEY MARKET IN PRESENT SANIRO

RUBY SHUKLA*

ROSY SHARMA**

Abstract:

The money market is better known as a place for large institutions and government to manage their short-term cash needs. However, individual investors have access to the market through a variety of different securities. Indian money market is not integrated with other global market therefore its not so liberalized n modernized, because of that very limited scope is there for investors.RBI and Government have taken policy decisions to create conducive environment. This paper, has attempted to cover the structure, drawbacks and the reforms taken by RBI for the development of money market.

Keywords: Financial market, Money market, Cash Reserve Ratio, Collateralized lending, Money market instruments

* Sr. Lecturer, Chandigarh Business School, Landran, Mohali.

** Lecturer, Chandigarh Business School, Landran, Mohali.

Overview of Financial Markets

Money may not make the world go round, but it certainly goes round the world. Recent years have seen the global growth of sophisticated financial markets. These markets and the institutions associated with them, bring people together, agents (such as investors) with surplus cash looking to generate returns deliver it to those who would like it now (such as borrowers). Efficient transfer of resources from those having idle resources to others who have a pressing need for them is achieved through financial markets. Stated formally, financial markets provide channels for allocation of savings to investment. These provide a variety of assets to savers as well as various forms in which the investors can raise funds and thereby decouple the acts of saving and investment. The savers and investors are constrained not by their individual abilities, but by the economy's ability, to invest and save respectively. The financial markets, thus, contribute to economic development to the extent that the latter depends on the rates of savings and investment. A financial market is a market in which people and entities can trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds, and commodities include precious metals or agricultural goods.

The financial markets can be divided into different subtypes:

- Capital markets which consist of:
  - Stock markets, which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof.
  - Bond markets, which provide financing through the issuance of bonds, and enable the subsequent trading thereof.
- Commodity markets, which facilitate the trading of commodities.
- Money markets, which provide short term debt financing and investment.
- Derivatives markets, which provide instruments for the management of financial risk.

- Futures markets, which provide standardized forward contracts for trading products at some future date; see also forward market.
- Insurance markets, which facilitate the redistribution of various risks.
- Foreign exchange markets, which facilitate the trading of foreign exchange.

Money Market is "the centre for dealings, mainly short term character, in money assets. It meets the short term requirements of the borrowers & provides liquidity or cash to the lenders. Money Market refers to the market for short term assets that are close substitutes of money, usually with maturities of less than a year. Money Market means market where money or its equivalent can be traded. Money is synonym of liquidity. Money Market consists of financial institutions and dealers in money or credit who wish to generate liquidity. It is better known as a place where large institutions and governments manage their short term cash needs. For generation of liquidity, short term borrowing and lending is done by these financial institutions and dealers. Money Market is part of financial market where instruments with high liquidity and very short term maturities are traded. Due to highly liquid nature of securities and their short term maturities are traded. Due to highly liquid nature of securities and their short term maturities, money market is treated as a safe place. Hence, money market is a market where short term obligations such as treasury bills, commercial papers and banker's acceptances are bought and sold. Billions of dollars in payments are made and received daily. Every user of the financial system ends the day with either a debit or credit in their account. Every debit has to be covered by borrowing, and every credit wants a return. The money market is a mechanism that deals with the lending and borrowing of short term funds or debt securities (bankers acceptances, commercial paper, repos, negotiable certificates of deposit, and Treasury Bills with a maturity of one year or less). Money market securities are generally very safe investments which return a relatively low interest rate that is most appropriate for temporary cash storage or short-term time horizons. Bid and ask spreads are relatively small due to the large size and high liquidity of the market. The Indian Money Market involves a wide range of instruments. The maturities range from one day to a year, issued by banks and corporate of various sizes.

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Structure of Indian Money Market

The Indian money market is divided in three segments:-

ORGANISED STRUCTURE	UNORGANISED SECTOR	CO-OPERATIVE SECTOR
i) Reserve bank of India. ii) DFHI (discount and finance house of India). iii) Commercial banks:- a. Public sector banks SBI with 7 subsidiaries b. 20 nationalized banks c. Indian and Foreign Private banks iv) Development bank IDBI, IFCI, ICICI, NABARD, LIC, GIC, UTI etc	i) Indigenous banks ii) Money lenders iii) Chits iv) Nidhis	i) State cooperative ii) Central co-operative banks iii) Primary Agri credit societies iv) Primary urban banks v) State Land development banks vi) Central land development banks vii) Primary land development banks

The following products are traded in money market

- Certificate of Deposit (CD)
- Commercial Paper (C.P)
- Inter Bank Participation Certificates Inter Bank Term Money
- Treasury Bills
- Call Money
- Banker's Acceptance REPO

Money market products (T-bills, CP,CD and Banker's Acceptances) are short-term fixed-income products that are sold at a discount and then mature at face value. The difference between your purchase price and par value is your return. Commercial Banks, Cooperative Banks & Primary Dealers are allowed to borrow and lend. Specified All-India Financial Institutions, Mutual Funds and certain specified entities are allowed to access to Call/ Notice money market only as lenders. Individuals, Firms, Companies, Corporate bodies, Trusts & Institutions can purchase the treasury bills, commercial papers and certificate of deposits.

Features of Indian Money Market

1. The Indian money market has a Dichotomic Structure. It has a simultaneous existence of both the organized money market as well as unorganized money markets. The organized money market consists of RBI, all scheduled commercial banks and other recognized financial institutions. However, the unorganized part of the money market comprises domestic money lenders, indigenous bankers, trader, etc. The organized money market is in full control of the RBI. However, unorganized money market remains outside the RBI control. Thus both the organized and unorganized money market exists simultaneously.

2. The demand for money in Indian money market is of a seasonal nature. India being an agriculture predominant economy, the demand for money is generated from the agricultural operations. During the busy season i.e. between October and April more agricultural activities takes place leading to a higher demand for money.

3. In Indian money market, we have many levels of interest rates. They differ from bank to bank from period to period and even from borrower to borrower. Again in both organized and unorganized segment the interest rates differs. Thus there is an existence of many rates of interest in the Indian money market.

4. In the Indian money market, the organized bill market is not prevalent. Though the RBI tried to introduce the Bill Market Scheme (1952) and then New Bill Market Scheme in 1970, still there is no properly organized bill market in India.

5. The Indian money market is not an integrated one.. At the same time it is divided among several segments or sections which are loosely connected with each other. There is a lack of coordination among these different components of the money market. RBI has full control over the components in the organized segment but it cannot control the components in the unorganized segment.

6. The call money market is a market for very short term money. Here money is demanded at the call rate. Basically the demand for call money comes from the commercial banks. Institutions such as the GIC, LIC, etc suffer huge fluctuations and thus it has remained highly volatile.

7. Instruments in Indian money market are very limited. It is in fact a defect of the Indian money market. In our money market the supply of various instruments such as the Treasury Bills, Commercial Bills, Certificate of Deposits, Commercial Papers, etc. is very limited. In order to meet the varied requirements of borrowers and lenders, It is necessary to develop numerous instruments.

Benefits of Money Market:

Money Markets exist to facilitate efficient transfer of short-term funds between holders and borrowers of cash assets. For the lender/investor, it provides a good return on their funds. For the borrower, it enables rapid and relatively inexpensive acquisition of cash to cover short-term liabilities. One of the primary functions of Money Market is to provide focal point for RBI's intervention for influencing liquidity and general levels of interest rates in the economy. RBI being the main constituent in the Money Market aims at ensuring that liquidity and short term interest rates are consistent with the monetary policy objectives. Money market provides a focal point for the central bank’s operations in influencing system liquidity and thereby transmitting the monetary policy impulses. The broad policy objectives that are being pursued for the development of money market include ensuring stability in short-term interest rates, minimizing default risk and achieving a balanced development of various segments of the money market.

An insight into the various defects and inadequacies of the Indian money market reveals that as compared to the advanced international money markets like the London Money Market, the New York Money Market, etc**.** Indian money market is still an undeveloped money market.

Drawbacks of Indian Money Market

1. **Absence of Integration** : The Indian money market is broadly divided into the Organized and Unorganized Sectors. The former comprises the legal financial institutions backed by the RBI. The unorganized statement of it includes various institutions such as indigenous bankers, village money lenders, traders, etc. There is lack of proper integration between these two segments.

2. **Multiple rate of interest** : There is no uniformity in the interest rate which vary considerably among different financial institutions as well as centers. In the Indian money market, especially the banks, there exists too many rates of interests. These rates vary for lending, borrowing, government activities, etc. Many rates of interests create confusion among the investors.

3. **Insufficient Funds or Resources** :It lacks sufficient and regular supply of short term assets such as bills of exchange, treasury bills, short term government bonds etc. The Indian economy with its seasonal structure faces frequent shortage of financial recourse. Lower income, lower savings, and lack of banking habits among people are some of the reasons for it.

4. **Shortage of Investment Instruments** : In the Indian money market various investment instruments such as Treasury Bills, Commercial Bills, Certificate of Deposits, Commercial Papers, etc. are used. But taking into account the size of the population and market these instruments are inadequate.

5. **Shortage of Commercial Bill** : In India, as many banks keep large funds for liquidity purpose, the use of the commercial bills is very limited. Similarly since a large number of transactions are preferred in the cash form the scope for commercial bills are limited.

6. **Lack of Organized Banking System**: In India even through we have a big network of commercial banks, still the banking system suffers from major weaknesses such as the NPA, huge losses, poor efficiency. The absence of the organized banking system is major problem for Indian money market.

7. **Less number of Dealers**: In the Indian money market there are no dealers in short term assets who can functions as intermediaries between the government and the banking system. There are poor number of dealers in the short-term assets who can act as mediators between the government and the banking system. The less number of dealers leads to the slow contact between the end lender and end borrowers.

8. No doubt, a well-developed call money market exits in India, there is absence of other necessary sub-market such as the acceptance market, commercial bill market, etc.

9. The Indian money market does not attract foreign funds and thus lack international status.

Reforms in Indian Money Market

While the need for long term financing is met by the capital or financial markets, money market is a mechanism which deals with lending and borrowing of short term funds. Post reforms period in India has witnessed tremendous growth of the Indian money markets. Banks and other financial institutions have been able to meet the high expectations of short term funding of important sectors like the industry, services and agriculture. Functioning under the regulation and control of the Reserve Bank of India (RBI), the Indian money *markets* have also exhibited the required maturity and resilience over the past about two decades. Decision of the government to allow the private sector banks to operate has provided much needed healthy competition in the money markets, resulting in fair amount of improvement in their functioning.

Money market denotes inter-bank market where the banks borrow and lend among themselves to meet the short term credit and deposit needs of the economy. Short term generally covers the time period up to one year. The money market operations help the banks tide over the temporary mismatch of funds with them. In case a particular bank needs funds for a few days, it can borrow from another bank by paying the determined interest rate. The lending bank also gains, as it is able to earn interest on the funds lying idle with it. In other words, money market provides avenues to the players in the market to strike equilibrium between the surplus funds with the lenders and the requirement of funds for the borrowers. An important function of the money market is to provide a focal point for interventions of the RBI to influence the liquidity in the financial system and implement other monetary policy measures.

Quantum of liquidity in the banking system is of paramount importance, as it is an important determinant of the inflation rate as well as the creation of credit by the banks in the economy. Market forces generally indicate the need for borrowing or liquidity and the money market adjusts itself to such calls. RBI facilitates such adjustments with monetary policy tools available with it. Heavy call for funds overnight indicates that the banks are in need of short term funds and in case of liquidity crunch, the interest rates would go up. Depending on the economic situation and available market trends, the RBI intervenes in the money market through a host of interventions. In case of liquidity crunch, the RBI has the option of either reducing the Cash Reserve Ratio (CRR) or pumping in more money supply into the system

The Reserve Bank has accorded prime attention to the development of the money market as it is the key link in the transmission mechanism of monetary policy to financial markets and finally, to the real economy. In the past, development of the money market was hindered by a system of administered interest rates and lack of proper accounting and risk management systems. With the initiation of reforms and the transition to indirect, market-based instruments of monetary policy in the 1990s, the Reserve Bank made conscious efforts to develop an efficient, stable and liquid money market by creating a favourable policy environment through appropriate institutional changes, instruments, technologies and market practices. Accordingly, the call money market was developed into primarily an inter-bank market, while encouraging other market participants to migrate towards collateralized segments of the market, thereby increasing overall market integrity.

In line with the objective of widening and deepening of the money market and imparting greater liquidity to the market for facilitating efficient price discovery the following measures were introduced:

1. Introduction of new instruments, such as collateralized lending and borrowing obligations (CBLO). Money market instruments such as market repo and CBLO have provided avenues for non-banks to manage their short-term liquidity mismatches and facilitated the transformation of the call money market into a pure inter-bank market.
2. Issuance norms and maturity profiles of other money market instruments such as Commercial paper (CP) and certificate of deposits (CDs) have been modified over time to encourage wider participation.
3. The abolition of *ad hoc* Treasury Bills and introduction of regular auctions of Treasury Bills Paved the way for the emergence of a risk free rate, which has become a benchmark for pricing the Other money market instruments.
4. Along with greater global integration of domestic markets, the Reserve Bank's emphasis has been on setting prudential limits on borrowing and lending in the call money market.
5. Encouraged migration towards the collateralized segments and developing derivative instruments for hedging market risks.
6. Institutionalization of the Clearing Corporation of India Limited (CCIL) as a central counterparty.
7. The up gradation of payment system technologies has also enabled market participants to improve their asset liability management.

All these measures have widened and deepened the money market in terms of instruments and participants, enhanced transparency and improved the signaling mechanism of monetary policy while ensuring financial stability. These policy initiatives over time have led to the development of a relatively deep, liquid and vibrant money market in the country. Activity in all the segments has increased significantly.

With the development of market repo and CBLO segments, the call money market has been transformed into a pure inter-bank market from August 2005. A recent noteworthy development is the substantial migration of money market activity from the uncollateralized call money segment to the collateralized market repo and CBLO markets. Thus, uncollateralized overnight transactions are now limited to banks and primary dealers in the interest of financial stability Volatility in call rates has declined over the years, especially after the introduction of the Liquidity Adjustment Facility (LAF). Under the LAF, the Reserve Bank sets its policy rates, *i.e.*, repo and reverse repo rates and carries out repo/reverse repo operations, thereby providing a corridor for overnight money market rates. The weighted average overnight rate has largely moved within the corridor set by LAF rates, barring some occasions.

The reduction in bid-ask spread in the overnight rates indicates that the Indian money market has become reasonably deep, vibrant and liquid. During April 2004−February 2007, the bid-ask spread has varied within a range of -0.37 to +1.32 basis points with an average of 16 basis points and standard deviation (SD) of 11 basis points (coefficient of variation being 68.8). Despite a higher degree of variation, however, the bid-ask spread remained within the 2-SD band around the average during most of the period.

Conclusion

The money market is a vibrant market, affecting our everyday lives. As the short-term market for money, money changes hands in a short time frame and the players in the market have to be alert to changes, up to date with news and innovative with strategies and products As a result of various reform measures, the money market in India has undergone significant transformation in terms of volume, number of instruments and participants and development of risk management practices. In line with the shifts in policy emphasis, various segments of the money market have acquired greater depth and liquidity. The price discovery process has also improved. The call money market has been transformed into a pure inter-bank market, while other money market instruments such as market repo and CBLO have developed to provide avenues to non-banks for managing their short-term liquidity mismatches. The money market has also become more efficient as is reflected in the narrowing of the bid-ask spread in overnight rates. The abolition of *ad hoc* Treasury Bills and introduction of Treasury Bills auction have led to the emergence of a risk free rate, which acts as a benchmark for the pricing of other money market instruments.

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