AIJRRLSJM VOLUME 2, ISSUE 2 (2016, FEB) (ISSN-2455-6602) ONLINE
ANVESHANA'S INTERNATIONAL JOURNAL OF RESEARCH IN REGIONAL STUDIES, LAW, SOCIAL SCIENCES, JOURNALISM AND MANAGEMENT PRACTICES

ROLE OF GOVERNMENT AND RBI IN INDIAN MONEY MARKET

BANOTH DEEPA
MBA
Kingston PG College, Ghatkesar

ABSTRACT

Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers. The money market is an unregulated and informal market and not structured like the capital markets, where things are organised in a formal way. Money market gives lesser return to investors

INTRODUCTION

There are two kinds of markets where borrowing and lending of money takes place between fund scarce and fund surplus individuals and groups. The markets catering the need of short term funds are called Money Markets while the markets that cater to the need of long term funds are called Capital Markets.

Thus, money markets are that segment of financial markets where borrowing and lending of the short-term funds takes place. The maturity of the money market instruments is one day to one year. In our country, Money Markets are regulated by both RBI and SEBI.

Indian money market is divided into organized and unorganized segments. Unorganized market is old Indigenous market mainly made of indigenous bankers, money lenders etc. Organized market is that part which comes under the regulatory purview of RBI and SEBI. The nature of the money market transactions is such that they are large in amount and high in volume. Thus, the entire market is dominated by small number of large players. At the same time, the money market in India is yet underdeveloped. The key players in the organized money market include Governments (Central and State), Discount and Finance House of India (DFHI), Mutual Funds, Corporate, Commercial / Cooperative Banks, Public Sector Undertakings (PSUs), Insurance Companies and Financial Institutions and Non-Banking Financial Companies (NBFCs).

Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers. 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.

Money market consists of negotiable instruments such as treasury bills, commercial papers. and certificates of deposit. It is used by many participants, including companies, to raise

funds by selling commercial papers in the market. Money market is considered a safe place to invest due to the high liquidity of securities.

MEANING AND NATURE OF INDIAN MONEY MARKET

The money market is not a market in the usual sense of the term. It does not mean a single trading place or trading organisation dealing in money. But "it is a collective name given to the various forms and institutions that deal with the various grades of near money". It is a market in short-term funds in which the lenders of money meet the borrowers of money. The lenders of money are the Reserve Bank of India, all scheduled commercial banks, co-operative banks, financial institutions like the LIC, UTI, GIC, foreign exchange banks, and indigenous bankers, moneylenders, etc. The borrowers of money are the Central Government, State Governments, local bodies, traders, merchants, businessmen, exporters, importers, companies, farmers, and the public. Thus the money market is a market for monetary assets in which the short-term requirements of the borrowers are met in order to provide liquidity or cash to the lenders.

Structure of Organised Money Market in India

The organized money market in India is not a single market but is a conglomeration of markets of various instruments. They have been discussed below:

Call Money / Notice Money / Term Money Market

Call Money, Notice Money and Term Money markets are sub-markets of the Indian Money Market. These refer to the markets for very short term funds. Call Money refers to the borrowing or lending of funds for 1 day. Notice Money refers to the borrowing and lending of funds for 2-14 days. Term money refers to borrowing and lending of funds for a period of more than 14 days.

Treasury Bill (T – Bills)

The bill market is a sub-market of the money market in India. There are two types of bills viz. Treasury Bills and commercial bills. While Treasury Bills or T-Bills are issued by the Central Government; Commercial Bills are issued by financial institutions.

Commercial Bills

Commercial bills market is basically a market of instruments similar to Bill of Exchange. The participants of commercial bill market in India are banks and financial institutions but this market is not yet developed.

Certificate Of Deposits (CDs)

Certificate of Deposit (CD) refers to a money market instrument, which is negotiable and equivalent to a promissory note. All scheduled commercial banks excluding Regional Rural

Banks (RRBs) and Local Area Banks (LABs) and Select All India Financial Institutions permitted by RBI are eligible to issue certificates of deposits.

Commercial Papers (CP)

Commercial Paper (CP) is yet another money market instrument in India, which was first introduced in 1990 to enable the highly rated corporate to diversify their resources for short term fund requirements.

Money Market Mutual Funds (MMMFs)

Money Market Mutual Funds (MMMFs) were introduced by RBI in 1992 but since 2000, they are brought under the purview of the SEBI. They provide additional short-term avenue to individual investors.

The Repo / Reverse Repo Market

Repo (repurchase agreement) was introduced in December 1992. Repo means selling a security under an agreement to repurchase it at a predetermined date and rate. Repo transactions are affected between banks and financial institutions and among bank themselves, RBI also undertake Repo. IN 1996, Reverse Repo was introduced. Reverse Repo means buying a security on a spot basis with a commitment to resell on a forward basis. Reverse Repo transactions are affected with scheduled commercial banks and primary dealers.

Discount And Finance House Of India (DFHI)

It was established in 1988 by RBI and is jointly owned by RBI, public sector banks and all India financial institutions which have contributed to its paid up capital. DFHI plays important role in developing an active secondary market in Money Market Instruments. From 1996, it has been assigned status of a Primary Dealer (PD). It deals in treasury bills, commercial bills, CDs, CPs, short term deposits, call money market and government securities.

Functions of Money Markets

Due to short maturity term, the instruments of money market are liquid and can be converted to cash easily and thus are able to address the need of the short term surplus fund of the lenders and short term borrowing requirements of the borrowers. Thus, the major function of the money markets is to cater to the short term financial needs of the economy. The other functions are as follows:

1. Money Markets help in effective implementation of the RBI's monetary policy

2. Money markets help to maintain demand and supply equilibrium with regard to short term funds

3. They cater to the short term fund requirement of the governments

4. They help in maintaining liquidity in the economy

Role of Government

To increase the constancy of Financial Institutions and Markets Government intervenes in the interest rates and money supply in the Money Markets. Government has several ways to control income and interest rates which can be divided into two broad groups such as,

- Fiscal policy
- Monetary policy

The government to adjust the exchange rate intervenes with the foreign exchange markets; there may be a result on the financial base and the supply of money. When the currency is falling, foreign currencies should be sold and the currency should be bought to steady its price. The use of deposits of the national currency to do this suggest that the prepared deposits of the banking sector must be reduced, causing the financial base to fall, affecting the supply of money. Equally by selling the national currency to decrease its rate, the monetary base will increase. Securities may be sold on the open market in an effort to dampen the effects of inflows of the national currency, but this would imply a raise in interest rates and cause the currency to rise further still. A number of institutions can affect the supply of money but the greatest impact on the money supply is had by the Reserve bank and the commercial banks.

Role of Central Bank (RBI)

- Firstly the central bank could do this by setting a necessary reserve ratio, which would restrict the ability of the commercial banks to increase the money supply by loaning out money. If this condition were above the ratio the commercial banks would have wished to have then the banks will have to create fewer deposits and make fewer loans then they could otherwise have profitably done. If the central bank imposed this requirement in order to reduce the money supply, the commercial banks will probably be unable to borrow from the central bank in order to increase their cash reserves if they wished to make further loans. They might try to attract further deposits from customers by raising their interest rates but the central bank may retaliate by increasing the necessary reserve ratio.

- The central bank can influence the supply of money through special deposits. These are deposits at the central bank which the banking sector is required to lodge. These are then frozen, thus preventing the sector from accessing them even though interest is paid at the

average Treasury bill rate. Making these special deposits reduces the level of the commercial banks' operational deposits which forces them to cut back on lending.

• The supply of money can also be prohibited by the central bank by adjusting its interest rate which it charges when the commercial banks wish to borrow money (the discount rate). Banks generally have a ratio of cash to deposits which they consider to be the minimum safe level. If command for cash is such that their reserves fall below this level they will able to borrow money from the central bank at its discount rate. If market rates were 8% and the discount rate were also 8%, then the banks might decrease their cash reserves to their minimum ratio knowing that if demand exceeds supply they will be able to borrow at 8%. The central bank, even if, may raise its discount rate to a value above the market level, in order to encourage banks not to reduce their cash reserves to the minimum during excess loans. By raising the discount value to such a level, the commercial banks are given an incentive to hold more reserves thus reducing the money multiplier and the money supply.

• Another way the money supply can be affected by the central bank is through its operation of the interest rate. By raising or lowering interest rates the demand for money is respectively reduced or increased. If it sets them at a certain level it can clear the market at level by supplying sufficient money to match the demand. Alternatively it could fix the money supply at a convinced rate and let the market clear the interest rates at the balance. Trying to fix the money supply is not easy so central banks regularly set the interest rate and provide the amount of money the market demands.

Conclusion:

Hence, "the Indian money market is characterized by a diversity of institutions at the apex of which stands the Reserve Bank of India and at the bottom of which there are the village money lenders cum traders. In between the two, we have the co-operative credit institutions, Post Office savings banks, indigenous bankers, joint stock banks inclusive of the State Bank of India, the various finance corporations of the Central as well as the State Governments, and the foreign exchange banks."

References :

1. *Brealey, Richard A., and Stewart C. Myers. Principles of Corporate Finance. 4th ed. New York:McGrawHill, 1991.*
2. *Brostoff, Steven. "Stable Value Products Pushed for Pensions." National Underwriter Property and Casualty. September*
3. *Nayar, Nandkumar and Michael S. Rozeff. "Commercial Paper and the Cost of Capital, Rating, and Equity Returns." Journal of Finance.*
4. *Retkwa, Rosalyn. "New CP-Funded Loans Broaden Market but Aren't Always Cheap." Corporate CashflowMagazine .*
5. *www.google.com*
6. *www.wikipedia.com*
7. *www.investopedia.com*

8. *https://www.gktoday.in/gk/structure-functions-of-money-market-in-india/*
9. *https://www.investopedia.com/university/moneymarket/moneymarket8.asp#ixzz4zTAWVXBY*
10. *http://shodhganga.inflibnet.ac.in/bitstream/10603/25149/11/11_conclusion.pdf*