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INFLUENCE OF MONEY MARKET ON INDIAN ECONOMY

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KEYWORDS :

INTRODUCTION

One of the most important pillars for the growth in the Indian economy is the Indian Financial System. Indian Financial System (IFS) consists of huge markets comprising of primary markets, secondary markets, derivative markets etc. one of the important markets is the money market.

Money market is the market in which the securities are issued for less than one year. This market is for those investors and borrowers who need instant cash for a short period of time. Like a company needs instant cash but is not willing to opt the mode of financial institution as they charge high rate of interest and would take time to issue loan, in that case one can go for the money market.

Our Indian Financial System is very wide. It consists of many sub-categories like financial institutions, financial markets, financial instruments and financial services. As the name suggests, this system helps in running the whole of economy. This paper basically explains the influence of money market in the Indian economy.

History

Money market was introduced by Bruce R. Bent and Henry B.R. Brown in 1971. Like other mutual funds, it was also regulated by SEC, and the maximum maturity period for the mutual funds was 13 months. Merrill Lynch, in 1977, launched the first cash management account. As money becomes a necessity in day to day life, so it becomes a part of financial market for the short term funds. Since 1944, most of the countries had domestic money market fund which shows the pooling of the foreign exchange reserves.

There was a great need after the World War II, as the investors moulded themselves towards the government securities. All the other money market securities were overshadowed as the war created lot of economic crisis. Most of the dealers had their head office in “NEW YORK” but all of them or most of them were engaged in the nationwide operations. The commonest form of dealer financing was the repurchase agreements. The markets for other type of investments like for bills of exchange, bank drafts or commercial paper.

Another type of money market instrument which was enjoying a huge response from the banks was the “certificate of deposits” in 1962. The owner of the CD was not having the rights to withdraw his deposits before the maturity period but he was having the right to sell the deposits in the secondary market anytime that can be conducted by the government securities dealers.

The federal system reserve conducts the daily operations of the money market instruments by taking its own in initiative so as to keep the financial mechanism smooth and subtle. This was done basically for the economic growth and stability and to limit the instability in the economy. The transactions basically included the outright sale and purchase of the government securities. It is still has to be the commercial banks which can create the demand for the money market instruments, and also the variety of the institutional investors are required who can create a mixture of the different types of the instruments and can channel the liquidity of the public's savings into various areas of uses.

Literature Review

Augustine and Nam (2012) had done the empirical study on the effect on the demand of money due to the changes in the exchange rates of Asian countries. May estimators and techniques have been experimented for obtaining the result of the short term dynamicity in the market. Due to imperfect results, it needs to the reallocation of securities which led to the negative impact towards the investors.

Varma (1997) analysed the level to which the interest rate parity can be held in India. He also analysed the relationship between the interest rates of the money markets. The ceilings of interest rate cannot affect the money market and its instruments but the structural barriers and the factors of various financial institutions distort the markets. Pandya (1992), explained that the SEBI has done and is continuously doing a lot for the protection of both big and small investors. The measures taken by SEBI provide huge room for the efficiency of the investors.

Features Of Money Markets:

- **Liquidity:** money market is the market which provides high amount of liquidity in the market. Securities can be easily convertible into cash as the maturity of the money market instruments are less than one year.
- **Maturity:** the maturity period of the money market instruments are of short term as the securities can be easily converted into cash within less than one year.
- **Risk:** there are various types of money market instruments which have different ratios of risk. For example: Commercial paper are the type of money market instruments which are risky in nature because it does not provide the security of the investments whereas T-bills are the type of money market government securities whose default risk is zero.
- **Short Term Notice Funds:** money market securities give the advantage of getting the funds in short term. If the companies are not able to get the funds from the other financial institutions, companies have the option of getting the funds from other sources.
- **Low Rate Of Interest:** money market securities are cheap to raise the funds as compared to banks and financial institutions.

Functions Of Money Market Instruments:

- **Profits for financial institutions:** money market instruments helps in gathering the profits in the short run. The investors who are risk takers and want to earn profits in short run can invest in money market.
- **Huge liquidity:** money market provides high degree of liquidity in the market. If any of the companies or the investors need anytime convertibility into cash can invest in money markets.
- **Quick transfer of funds:** funds can be transferred easily from one place to another in a short span of time.
- **Economic growth:** as more and more investments occur in the money market there increases great chances of economic growth.

Types Of Money Market Instruments

There are various types of instruments which forms a part of such markets. Some of them are:

- **Commercial paper:** commercial paper is an unsecured money market instrument which helps the big companies to raise funds in short notice. The maturities of such paper are always less than 1 year. Whenever a company wants to raise funds and does not want to go for banks or any other financial institutions, they can raise their company's commercial papers. These are commonly in the multiples of $1, 00,000.

- **Certificate of deposits:** certificate of deposits can be same as commercial paper but these are issued by banks. This is an agreement between the depositor and the bank where a predetermined amount of money is fixed for some time period. The maturity period of CDs is less than 1 year. Commonly issued multiples of CDs are 1 lakhs. Stamp duty is required while issuing the certificate of deposits.
- **T-Bills:** T-Bills are the short term government securities which are issued by the government. The investors who are risk aversors go with the t- bill securities. These are issued at discount and redeemed at par. The difference between the issue price and the redemption price is knob as the profits. The default risk in these securities is zero.
- **Banker's acceptance:** A financial that is instrument produced by an individual or a company, in the bank's name is known as Banker's Acceptance. It is required for the issuer to pay the instrument holder a predetermined amount on a specified date whose maturity is less than 1 year. It is a secured financial instrument because the guarantor here is the bank. The instruments are issued at discount and discounted at par and the difference between the two is known as profit.

Challenges:

- **Shortage of capital:** one of the biggest challenges that the money market faces is the shortage of capital. Possible reasons for shortage of capital would be: a) inadequate savings b) improper banking facilities c) less banking habits of people.
- **Seasonal shortage:** during the festive seasons, people in India spend more due to which the savings of these become less. Hence, this behaviour of people leads to shortage of funds in the market.
- **Sector classification:** due to the classification of the sectors between organized and unorganized, this leaves a very small coordination.
- **Unorganized sector dominance:** in rural areas, the investments and the borrowings are basically undetermined between the short term and the long term, due to which it is difficult to say the clear cut interpretation.
- Useless competition: not only between the organized and the unorganized sectors, members in the same sectors also have rivalry between the banks, between financial institutions etc.
- **Improper and inadequate banking facilities:** many of the areas are still deprived from the banking facilities. Though, there has been a rapid increase of bank branches after its nationalization, yet there are many rural areas where people cannot use banking facilities.

Recent Developments In Money Market:

- A big step has been taken by the government for the growth of Indian money market. The government had passed the orders to nationalize the commercial banks so that a smooth flow of money can be prevailed.
- Many acts have been passed in the favour of the people who need borrowings and are not able to fulfil the conditions of the money lenders and the landlords. The passing of public debt relief act and the urban debt relief act has helped many of the rural and the urban poor.
- Stamp duty has been reduced up to a certain level and the rediscounting rate on promissory note has become a trend now-a-days. In 1986, the Government had issued 180-day T bills and in 1989 CDs, and CPs in 1990. In 1991, MMMF was launched to allow more and more people to take part in the money market activities in India.
- Earlier the interest rates were under the control of RBI, but now it has been deregulated.
- Repurchase of options of treasury bills by RBI provides additional funds to the commercial banks.
- Many relaxations have been provided by the government to various sectors so that there could be more flexibility in the investments in the money markets.

CONCLUSION:

Money market forms one of the most important parts of Indian Financial System. The investment in this market leads to good amount of profits to the investors in short run. The investors who want profits in short run can opt for this market. Such markets need proper care and attention so that it can reap good profits. Money market has huge potential of increasing GDP, if given proper recommendations this can be a boon to the economy.

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