Money Market and Secondary Market

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Abstract:
Financial instruments with high liquidity and very short maturities are traded. Used by participants as a means for borrowing and lending in the short term, from several days to just under a year. 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 and banker's acceptances are bought and sold. A market in which individuals and institutions trade financial securities. Markets that trade equity (stocks) and debt (bonds) instruments with maturities of more than one year (long term maturity). Organizations/institutions in the public and private sectors also often sell securities on the capital markets in order to raise funds. Here the author wants to communicate the functions and basic features of money as well as secondary market.

Keyword: *Money, Money market, Secondary market*

1. Definition

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. Capital markets are financial markets for the buying and selling of long-term debt or equity-backed securities. These markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.

2. Functions of the money market

The money market functions are:

1. Financing Trade

Money Market plays crucial role in financing both internal as well as international trade. Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market. The acceptance houses and discount markets help in financing foreign trade.

2. Financing Industry

Money market contributes to the growth of industries in two ways:

(a) Money market helps the industries in securing short-term loans to meet their working capital requirements through the system of finance bills, commercial papers, etc.

(b) Industries generally need long-term loans, which are provided in the capital market. However, capital market depends upon the nature of and the conditions in the money market. The short-term interest rates of the money market influence the long-term interest rates of the capital market. Thus, money market indirectly helps the industries through its link with and influence on long-term capital market.

3. Profitable Investment

Money market enables the commercial banks to use their excess reserves in profitable investment. The main objective of the commercial banks is to earn income from its reserves as well as maintain liquidity to meet the uncertain cash demand of the depositors. In the money market, the excess reserves of the commercial banks are invested in near-money assets (e.g. short-term bills of exchange) which are highly liquid and can be easily converted into cash. Thus, the commercial banks earn profits without losing liquidity.

4. Self-Sufficiency of Commercial Bank

Developed money market helps the commercial banks to become self-sufficient. In the situation of emergency, when the commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higher interest rate. On the other hand, they can meet their requirements by recalling their old short-run loans from the money market.

5. Help to Central Bank

Though the central bank can function and influence the banking system in the absence of a money market, the existence of a developed money market smoothens the functioning and increases the efficiency of the central bank.

3. Money market helps the central bank in two ways

(a) The short-run interest rates of the money market serves as an indicator of the monetary and banking conditions in the country and, in this way, guide the central bank to adopt an appropriate banking policy,

(b) The sensitive and integrated money market helps the central bank to secure quick and widespread influence on the sub-markets, and thus achieve effective implementation of its policy.

4. What are the functions and importance of Capital Market?

Capital market plays an important role in mobilising resources, and diverting them in productive channels. In this way, it facilitates and promotes the process of economic growth in the country.

Various functions and significance of capital market are discussed below:

1. Link between Savers and Investors

The capital market functions as a link between savers and investors. It plays an important role in mobilising the savings and diverting them in productive investment. In this way, capital market plays a vital role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the country.

2. Encouragement to Saving

With the development of capital, market, the banking and non-banking institutions provide facilities, which encourage people to save more. In the less- developed countries, in the absence of a capital market, there are very little savings and those who save often invest their savings in unproductive and wasteful directions, i.e., in real estate (like land, gold, and jewellery) and conspicuous consumption.

3. Encouragement to Investment

The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and nonbank financial institutions. Various financial assets, e.g., shares, securities, bonds, etc., induce savers to lend to the government or invest in industry. With the development of financial institutions, capital becomes more mobile, interest rate falls and investment increases.

4. Promotes Economic Growth

The capital market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions of the capital market, like nonbank financial intermediaries, allocate the resources rationally in accordance with the development needs of the country. The proper allocation of resources results in the expansion of trade and industry in both public and private sectors, thus promoting balanced economic growth in the country.

5. Stability in Security Prices

The capital market tends to stabilise the values of stocks and securities and reduce the fluctuations in the prices to the minimum. The process of stabilisation is facilitated by providing capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

6. Benefits to Investors

The credit market helps the investors, i.e., those who have funds to invest in long-term financial assets, in many ways:

(a) It brings together the buyers and sellers of securities and thus ensure the marketability of investments,
(b) By advertising security prices, the Stock Exchange enables the investors to keep track of their investments and channelize them into most profitable lines,
(c) It safeguards the interests of the investors by compensating them from the Stock Exchange Compensating Fund in the event of fraud and default.

5. Difference between Money Market and Capital Market

Points	Money Market	Capital Market
Definition	Is a component of the financial markets where short-term borrowing takes place	Is a component of financial markets where long-term borrowing takes place
Maturity Period	Lasts anywhere from 1 hour to 90 days.	Lasts for more than one year and can also include life-time of a company.
Credit Instruments	Certificate of deposit, Repurchase agreements, Commercial paper, Eurodollar deposit, Federal funds, Municipal notes, Treasury bills, Money funds, Foreign Exchange Swaps, short-lived mortgage and asset-backed securities.	Stocks, Shares, Debentures, bonds, Securities of the Government.
Nature of Credit Instruments	Homogenous. A lot of variety causes problems for investors.	Heterogeneous. A lot of varieties are required.
Purpose of Loan	Short-term credit required for small investments.	Long-term credit required to establish business, expand business or purchase fixed assets.
Basic Role	Liquidity adjustment	Putting capital to work
Institutions	Central banks, Commercial banks, Acceptance houses, Nonbank financial institutions, Bill brokers, etc.	Stock exchanges, Commercial banks and Nonbank institutions, such as Insurance Companies, Mortgage Banks, Building Societies, etc.
Risk	Risk is small	Risk is greater
Market Regulation	Commercial banks are closely regulated to prevent occurrence of a liquidity crisis.	Institutions are regulated to keep them from defrauding customers.
Relation with Central Bank	Closely related to the central banks of the country.	Indirectly related with central banks and feels fluctuations depending on the policies of central banks.

6. Advantages and Disadvantages of Money Market

6.1 Advantages

A money market account, or money market deposit account, is a government-insured bank account that pays relatively high interest rates and provides cash withdrawal privileges. This type of account offers both savings and checking tools at higher yields than regular savings and checking accounts. Money market accounts are offered by banks and credit unions and have several significant advantages and disadvantages.

1. Higher Rate of Interest

Money market accounts pay higher interest rates than other types of bank accounts, including passbook savings accounts and regular savings accounts, provided they maintain the minimum balance. The interest rate is tiered, compounded and credited monthly so that a money market account accrues more profit as the account balance increases.

2. Low Risk

The independent Federal Deposit Insurance Corp. insures money market accounts up to the $250,000 limit per account, making them low-risk and safe investments. This makes the account popular with investors as it protects them against loss of deposit.

3. Easy Access

Account holders can easily access their money market accounts through ATMs, transfers and checks. Banks, however, put a limit on the number of transactions and transfers per month.

6.2 Disadvantages

1.High Balance Requirement

Financial institutions require account holders to maintain a minimum balance in their money market accounts. Bank of America, for example, requires a minimum balance of $2,500 in all its money market accounts. Commerce Bank's Premium Money Market Account specifies an average daily balance of $5,000. Accounts that do not maintain this minimum are fined.

2. Limited Number of Withdrawals and Transfers

Most money market accounts allow only a limited number of monthly withdrawals and transfers as per federal banking regulations. For example, the National Alliance Bank permits no more than six withdrawals per statement cycle. Commerce Bank's Premium Money Market Account allows up to six transfers or withdrawals per month. This poses an inconvenience to a customer who needs to make an emergency withdrawal that will exceed the number of withdrawals permitted.

3. Interest Rate Fluctuation and Other Fees

A variable and fluctuating interest rate applies on a money market account. The interest rate depends on changes in the overall market interest rates. Banks and other depository institutions offering money market accounts establish fees for account maintenance, transactions and other financial services -- which reduce the value of the account.

7. Advantages and Disadvantages of Capital Market:

7.1 Advantages

1. Effective Risk Management

- Manage security exposure, market, and operations risk.
- Handle compliance issues, regulatory requirements, security, and other operational risks without burdening existing operations

2. Customer-centric Business Model

- Capture investment profiles to target offers and leads, while shortening sales cycles and increasing investment offers.
- Personalize customer experience across channels

3. Operational Effectiveness-

- Manage security exposure, market and operations risk. and Provide Real time and near real time actionable customer and product profitable insight, delivered to the front office.

- Profitable for Investor- The resulting advantages include that innovation is driven forward in a free, capitalist economy, with investors receiving dividends from successful ventures. This money can then be used in other projects that an investor might be passionate and enthusiastic about.

7.2 Disadvantages

1. Volatility is another issue - and with long-term investments.
2. May be high charges which reduce earnings from investment returns.
3. No guarantee of returns
4. Risk of losing your money.

Reference

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