Money Market: Objectives, Functions and Limitations

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Read this article to learn about Money Market. After reading this article you will learn about: 1. Definition of Money Market 2. Importance of Money Market 3. Objectives 4. Nature 5. Functions 6. Limitations.

Definition of Money Market:

Money market is the market for short-term loanable funds, as distinct from the capital market which deals in long-term funds.

Money market is also defined as a mechanism through which short-term funds are loaned and borrowed and through which a large part of the financial transactions of a particular country are cleared.

Broadly speaking, it includes the entire mechanism employed in financial business of all types. In the narrow sense, a money-market types of loans, such as call loans and in credit i which personal relations between lender and b

In this sense, a money market is distinct from but supplementary to, the commercial banking system.

Importance of Money Market:

The money market meets the short-term requirements of the borrowers and provides liquidity to the lenders. These markets therefore provide information for monetary policy formulation and management.

The Reserve Bank of India occupies a strategic position in the money market by changing the level of liquidity in the economy through open market operations and by regulating the access of the banks to its accommodation.

It is for this reason that development of a money market itself becomes an important monetary regulation measure. Money markets are not merely a channel for transferring short-term funds from savers to investors, but also provide information on the underlying conditions of supply and demand.

More importantly, they are essential for moving from quantity based to market-based instruments of monetary management. There is, therefore, an urgent need for deepening and broad-basing the market for debt instruments and Govt. dated securities. Institutional support should be provided wherever needed.

Objectives of Money Market:

The objectives of the money market are to impl

country. Monetary policy has three main object stability. The objective of the monetary policy in the first decade of planning was the revival of traditional weapons of monetary control.

In the second decade, the emphasis shifted to economic growth and control of money supply. During the 70's and 80's faster economic growth and price stability assumed importance. The credit policy on the other hand, has been evolved to meet the credit needs of the developing economy and on the other hand, to keep in check inflationary prices. This policy has come to be known as "controlled expansion".

In addition the monetary policy takes care of promotional aspects such as:

(i) Monetary integration of the country,

(ii) Directing credit flow according to policy priorities,

(iii) Assisting in mobilisation of the savings of the community,

(iv) Promotion of capital formation and

(v) Maintain an appropriate structure of relative prices and demand containment.

When the balance of payments situation acquired crisis dimension in mid 1990-91 the RBI through its monetary and credit policy measures aimed at import compression and demand containment. Since then the focus of monetary policy has changed in consistent with a comprehensive package of stabilisation and structural reforms measures initiated in mid-1991.

Nature of Money Market:

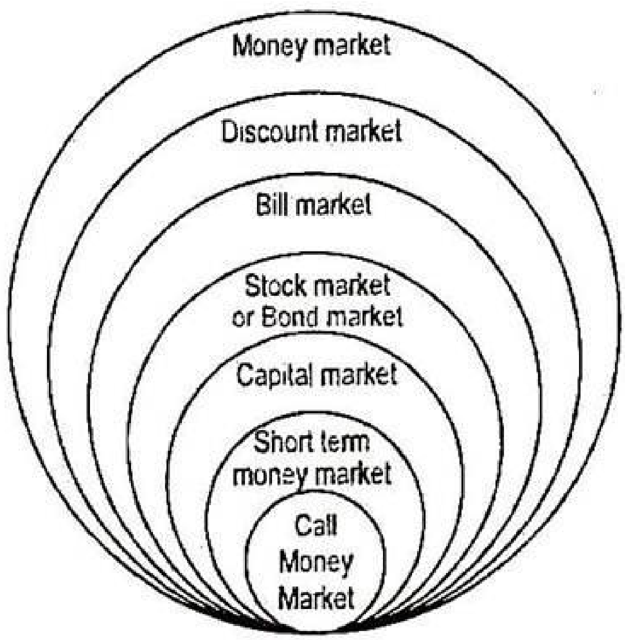
The development of securities markets usually starts with trading in a short-term money market instrument, often a Govt. security. Other money market instruments are interbank deposits, bankers' acceptances, certificates of deposits and commercial papers issued by nonfinancial corporations. Monetary markets provide a non-inflationary way to finance Govt. deficits.

Moreover, money markets are a source of funds

institutions including foreign banks and leasing large corporations to issue short-term securities in the form of commercial paper, money markets make the corporate loan market more competitive and reduce the market power of large commercial banks.

With the development of the economy, the money market is composed of money sub-markets of every country in the form of institutions that lend and borrow money for short periods.

Some of these markets such as call money market, short-term market, capital market, stock market, bill market, discount market etc. are highly developed and well organised. The larger the number of sub-markets the broader and more developed is the structure of the money market.



Sub-market within the Organised Money Market

Functions of Money Market:

The nature of money market reveals the functions of the money market.

Now we can list down such functions precisely:

1. A money market by providing profitable inve
surplus funds helps to enhance the profit of fin

2. A money market enhances the amount of liq

3. A well-developed money market helps to avoid wide seasonal fluctuations in the interest rates.

4. A well-developed money market, through quick transfer of funds from one place to another, helps to avoid the regional gluts and stringencies of funds.

5. By providing various kinds of credit instruments suitable and attractive for different sections, a money market augments the supply of funds.

6. A well organised money market is essential for the successful operation of the central banking policies.

Limitations of Money Market:

Unlike other well developed capital markets, Indian capital market has not developed in that manner. The capital market has become almost synonymous with equity market. The debt market which is many time bigger than equity market, in developed countries like USA, UK and Japan has hardly developed in India. The Govt. securities market is confined only to banks and institutions and to some extent to provident funds.

The second major requirement for the development of a healthy capital market is the presence of active bond dealers who not only act as intermediaries but also markets in the debt Indian debt market lacks depth as it does not have resourceful mature dealers in debt in instrument.

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