

FACULTY OF JURIDICAL SCIENCES

Lecture-14



MONEY MARKET

The money market refers to trading in very short-term debt investments. At the wholesale level, it involves large-volume trades between institutions and traders. At the retail level, it includes money market mutual funds bought by individual investors and money market accounts opened by bank customers.

In all of these cases, the money market is characterized by a high degree of safety and relatively low rates of return.

- The money market involves the purchase and sale of large volumes of very short-term debt products, such as overnight reserves or commercial paper.
- An individual may invest in the money market by purchasing a money market mutual fund, buying a Treasury bill, or opening a money market account at a bank.
- Money market investments are characterized by safety and liquidity, with money market fund

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.

It has certain risks which investors should be aware of, one of them being default on securities such as commercial papers. Money market consists of various financial institutions and dealers, who seek to borrow or loan securities. It is the best source to invest in liquid assets.

The money market is an unregulated and informal market and not structured like the capital markets, where things are organized in a formal way. Money market gives lesser return to investors who invest in it but provides a variety of products.

Withdrawing money from the money market is easier. Money markets are different from capital markets as they are for a shorter period of time while capital markets are used for longer time periods.

Money Market Instruments

Money Market Funds

The wholesale money market is limited to companies and financial institutions that lend and borrow in amounts ranging from \$5 million to well over \$1 billion per transaction. Mutual funds offer baskets of these products to individual investors. The net asset value (NAV) of such funds is intended to stay at \$1. During the 2008 financial crisis, one fund fell below that level. That triggered market panic and a mass exodus from the funds, which ultimately led to additional restrictions on their access to riskier investments.

Money Market Accounts

Money market accounts are a type of savings account. They pay interest, but some issuers offer account holders limited rights to occasionally withdraw money or write checks against the account. (Withdrawals are limited by federal regulations. If they are exceeded, the bank promptly converts it to a checking account.) Banks typically calculate interest on a money market account on a daily basis and make a monthly credit to the account.

In general, money market accounts offer slightly higher interest rates than standard savings accounts. But the difference in rates between savings and money market accounts has narrowed considerably since the 2008 financial crisis. Average interest rates for money market accounts vary based on the amount deposited. As of August 2021, the best-paying money market account with no minimum deposit offered 0.56% annualized interest.

Certificates of Deposit (CDs)

Most certificates of deposit (CDs) are not strictly money market funds because they are sold with terms of up to 10 years. However, CDs with terms as short as three months to six months are available.

As with money market accounts, bigger deposits and longer terms yield better interest rates. Rates in August 2021 for 12-month CDs ranged from about 0.50% to 0.70% depending on the size of the deposit. Unlike a money market account, the rates offered with a CD remain constant for the deposit period. There is usually a penalty associated with an early withdrawal of funds deposited in a CD.

Commercial Paper

The commercial paper market is for buying and selling unsecured loans for corporations in need of a short-term cash infusion. Only highly creditworthy companies participate, so the risks are low.

Bankers Acceptances

The banker's acceptance is a short-term loan that is guaranteed by a bank. Used extensively in foreign trade, a banker's acceptance is like a post-dated check and serves as a guarantee that an importer can pay for the goods. There is a secondary market for buying and selling banker's acceptances at a discount.