Function of Money Market and Capital Market

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Abstract:

The development of both Money market and Capital market has been active in fostering its economic advancement which overshadowed the growth of its monetary market. In the course of the past fifteen years reforms have bolstered the capital market's importance within the framework of overall economic reform. Initially development emphasized mobilization of available financial resources through government securities to resolve the central government deficit. The bond market evolved into an essential instrument of financial discipline illustrating the degree of government dependence on this market. .As the market advanced, the government securities market started transforming to more of a true market, although it was still heavily regulated. This transformation marks a slow shift to a market driven economy. The evolution of the capital market of China illustrates the difficulties encountered in the shift from a command economy to a market economy. The attempts of the government to control it and at the same time loosen its grip were most responsible for the development of the economy.

Keywords: money market; capital market; financial market; legal basis; international practice, Financial sector, financial innovation.

Introduction:

The financial market serves as a meeting ground for those who want to buy and sell financial instruments. This market helps to connect investors and savers, acting as a way to fund various activities. To put it another way, the financial market is where money changes hands, involving everyone from individuals to institutions that help with these transactions (intermediation). It also includes financial tools, processes, rules, and accepted practices. The main goal of financial intermediation is to move available money in the economy (savings) to those who need it (Losoncz-Farkas, 2011). Within the financial market, there are money markets and capital markets. The difference between them is due to how each country or culture finances its economy, which depends on local customs. Some places rely on commercial banks for financing, often through short-term loans. Others use stock exchanges to provide direct funding through securities, which usually have longer terms.

Experts usually divide financial markets into money markets and capital markets. The key question is how to separate these two beyond just the length of time involved, and why that division matters. We want to create a clear definition that can be used consistently in discussions, academic work, and legal contexts.

This disagreement comes from the different ways people look at it. Some focus on the types of products (like securities) when defining the capital market, while others focus on the time frame (short-term). However, existing definitions either don't resolve the conflict between these views (for example, short-term securities) or treat them as exceptions to the rule.

Review of Literature: -

Reuters (2009) Article: India call money ends near reverse repo rate, cash abundant. India overnight money rates brought down to the reverse repo rate of 3.25% on Wednesday these cash surplus in the system will help the banks meet their reserve needs comfortably. Cheaper money usable at the security borrowing and lending agreement (CBLO) also reduce the pressure on the inter-bank cash rates. On that day banks were guided to report their position to RBI once in two weeks. This alteration created an expectation on liquidity resistance. And some analysts said that the central bank may start rolling back the liquidity as early as on December 2009, as they already pressured the consumer prices could pose significant inflationary threat to the economy, in the thick of easy cash conditions Overnight rates are supported around the reverse repo rate because banks holding the surplus funds could also break up with the same central bank at that rate in its daily liquidity adjustment auctions.

Rastogi Nikhil (2008) Article: Money Market Integration in India: A Time Series Study Says that Indian financial markets have achieved much from the highly controlled pre-liberalization era. He denotes that the main focus is on achieving efficiency, which is the trade mark of any developed financial market. This research paper tests the efficiency and extent of integration between financial markets observed at the short end of the market.

The rates are mainly taken for the purpose of the study of, the compound call market rate, CD (Certificate of Deposit) rate, CP (Commercial Paper) rate, 91-day T-bill (Treasury bill) rate and 3-month forward premium.

The results, though promising, are mixed. In his research he concluded that although markets have achieved integration in some of its branches, but they still have to attain full integration.

It has absolute implications on the monetary policy of the Reserve Bank of India. (RBI) since the changes in one market (gilt market) can be used to coordinate the other market (forex market).

Reserve Bank of India (2010) in his discussion paper “Deregulation of Savings bank Interest rates: A Discussion paper” try to put the pros and cons of deregulation of savings deposits interest rates in India. Regulation of interest rates imparts rigidity to the instrument/product as rates are either not changed in response to changing market conditions or changed slowly. This adversely affects the attractiveness of a product/instrument. In the case of savings bank deposits, its interest rate has remained unchanged at 3.5 per cent since March 1, 2003 even as the Reserve Bank’s policy rates and call rates (representing a proxy for operative policy rate as at a time, only one rate – either the repo rate or the reverse repo rate – is operative depending on liquidity conditions) moved significantly in either direction. Regulation of savings deposits interest rate has not only reduced its relative attractiveness but has also adversely affected the transmission of monetary policy. For transmission of monetary policy to be effective, it is necessary that all rates move in tandem with the policy rates. This suggests that regulation of the interest rate on savings deposits has impeded the monetary transmission and that deregulation of interest rate will help improve the transmission of monetary policy.

In sum, deregulation of savings deposit interest rates has both pros and cons. Savings deposit interest rate cannot be regulated for all times to come when all other interest rates have already been deregulated as it creates distortions in the system. International experience suggests that in most of the countries, interest rates on savings bank accounts are set by the commercial banks based on market interest rates.

Research Methodology:

Methodology is an essential part of research to find answer to the research objective that initiate the same. Therefore, it figures as an important part of the study. This chapter focuses on the design and research method utilized in the study. In addition, the procedure followed to collect, capture, process and analyzed data is presented. The research approach used in the study is presented below:

Data Collection: -

Data for the study was collected from the primary as well as secondary sources.

PRIMARY SOURCE OF DATA COLLECTION: -

Primary source of data collection consisted of survey method. The survey was collected through a Structured Questionnaire. The questionnaire was prepared keeping in mind the objectives of the study and factors that were to be considered for the study. Questionnaire was prepared in such a manner that it could be easily understood by the respondents. The questionnaire being structured was in a single format to save time of the respondents.

SECONDARY SOURCE OF DATA COLLECTION: -

The secondary source of data collection is assessed to gain information and knowledge about our research problem that may be previously discussed by some other researcher. The secondary is referred to know what has already been discussed and what more scope can be there for research.

The secondary data is taken from selective websites and from online publication of some researchers. The secondary data was useful for the study of Review of Literature. We could study various aspects of different researchers which gave us an idea about the factors being previously discussed and also the conclusions drawn from them. It also gave us an insight on what more could be studied to solve the research problem.

Finding And Suggestion:

The implications of finding money market and capital market are numerous and significant. Here are some of the key implications:

Money Market Implications:

1. Short-term Funding: Money markets provide short-term funding options for individuals, businesses, and governments.

2. Liquidity Management: Money markets help manage liquidity by providing a platform for buying and selling short-term securities.

3. Risk Management: Money markets offer risk management tools, such as hedging and derivatives, to mitigate interest rate and credit risks.

4. Monetary Policy Transmission: Money markets play a crucial role in transmitting monetary policy decisions to the broader economy.

Capital Market Implications:

1. Long-term Funding: Capital markets provide long-term funding options for businesses, governments, and individuals.

2. Investment Opportunities: Capital markets offer investment opportunities for individuals, institutions, and governments.

3. Risk Capital: Capital markets provide risk capital for businesses, enabling them to invest in new projects and expansion.

4. Economic Growth: Capital markets contribute to economic growth by facilitating the allocation of resources to productive sectors.

Combined Implications:

1. Financial Intermediation: Money and capital markets facilitate financial intermediation, enabling the flow of funds from savers to investors.

2. Economic Efficiency: The presence of both money and capital markets promotes economic efficiency by allocating resources to their most productive uses.

3. Financial Stability: The interaction between money and capital markets helps maintain financial stability by providing a mechanism for managing risk and absorbing shocks.

4. Investor Confidence: The existence of both markets helps build investor confidence, as investors can choose

from a range of investment options and manage their risk exposure.

CONCLUSION

To sum up, the money market is a key component of the financial system as it is the fulcrum of monetary operations conducted by the central bank in its pursuit of monetary policy objectives. It is a market for short-term funds with maturity ranging from overnight to one year and includes financial instruments that are deemed to be close substitutes of money. The money market performs three broad functions. Firstly, it provides an equilibrating mechanism for demand and supply of short-term funds. Secondly, it enables borrowers and lenders of shortterm funds to fulfil their borrowing and investment requirements at an efficient market clearing price. Three, it provides an avenue for central bank intervention in influencing both quantum and cost of liquidity in the financial system, thereby transmitting monetary policy impulses to the real economy. The objective of monetary management by the central bank is to align money market rates with the key policy rate. As excessive money market volatility could deliver confusing signals about the stance of monetary policy, it is critical to ensure orderly market behaviour, from the point of view of both monetary and financial stability. Thus, efficient functioning of the money market is important for the effectiveness of monetary policy.

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