Imarticus Learning

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Basics of Money Markets

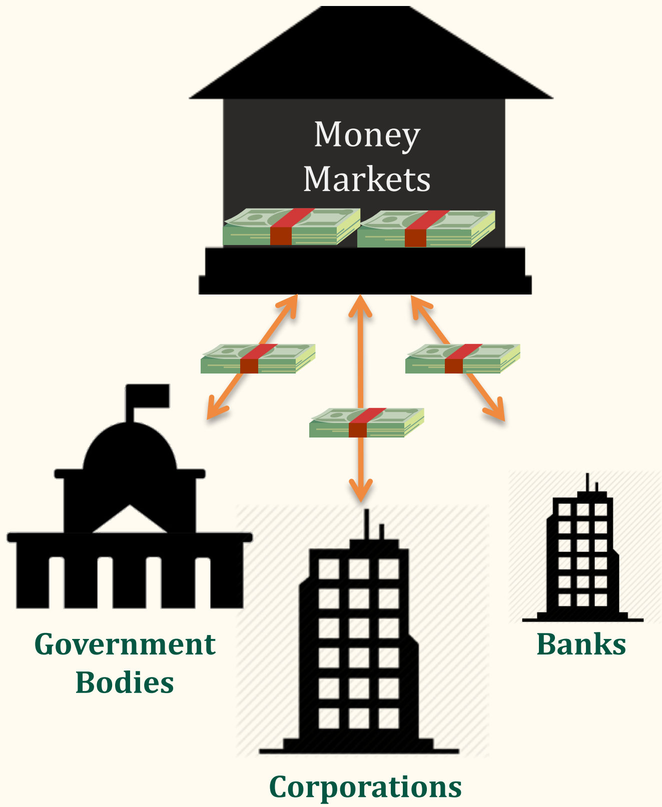
Agenda

In this session, you will learn about:

- Basics of Money Markets
- The purpose of money markets
- Money markets segments and participants
- Money market instruments
- Advantages and Disadvantages of Money Market

Introduction of Money Markets

Money market is a part of the **global financial market** that deals with **short-term lending and borrowing**.



Who do Money Markets Cater to?

Mode of Transaction

The transactions may take place between different persons by telephone, fax without personal meeting.

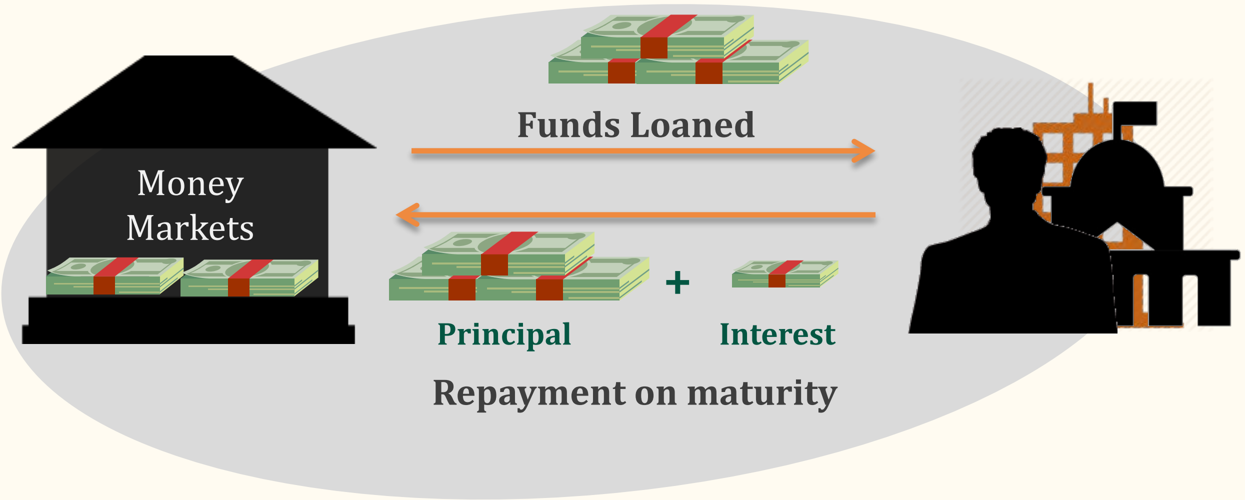
Period of Funding

Funds are available in this market for periods ranging from a single day up to a year.

Money Market Segments

InterBank Market	▪ Interbank market is referred mainly as the market for very short deposits and loans, e.g. overnight or up to two weeks
▪ Primary market, which is absorbing the issues and enabling borrowers to raise new funds.	Primary market
Secondary market	Secondary Markets provide trading of Short-term securities, ensuring liquidity and price discovery
▪ Market for financial contracts whose values are derived from the underlying money market instruments.	Derivatives Market

Interest Calculation



- For Interbank lending and some Money market instruments , interest is payable on the principal value of the instrument.

- Interest is paid at the end of the loan period, along with repayment of principal to the investor.

Interest Calculation

Key Assumption

Interest on most currencies, including U.S. dollar and euro, is calculated with assumption that year has 360 days and is based on ACT/360 day count convention.

Formula

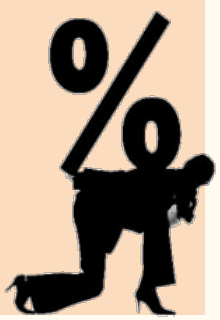
Interest payable = P*(R/100)*(T/360)

Where:

P = Principal

R = Interest rate

T= no. of days for which money is borrowed



Numerical Example of Interest Calculation

A bank makes loan of EUR 10mn

Duration of loan is 15th July – 15th October

Interest rate is 5.75 per annum

Interest Payable	= 10,000,000 * (5.75/100)*(92/360) = EUR 146,945

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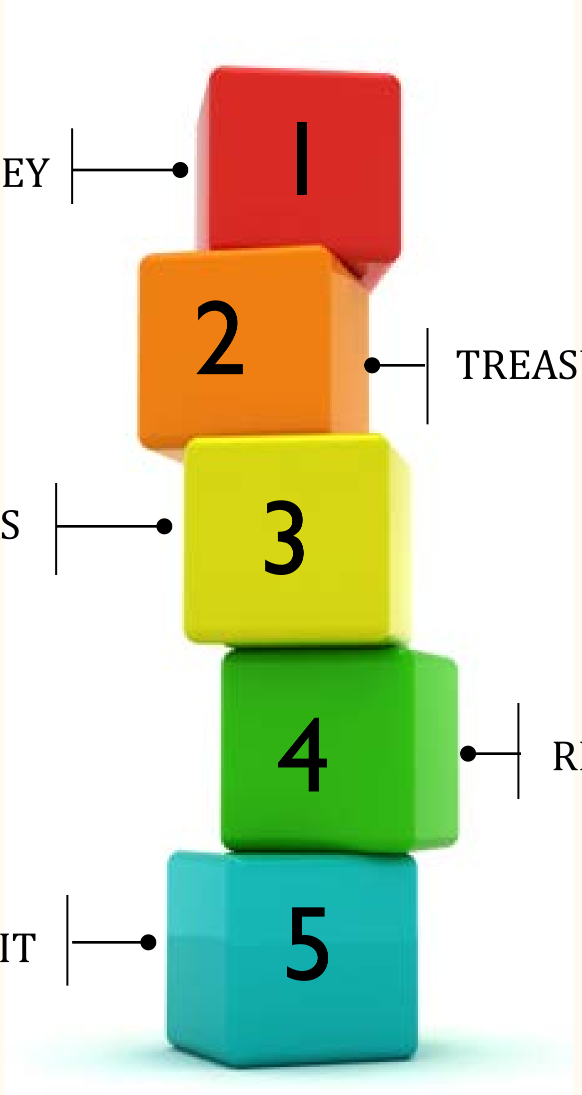
For certain currencies such as sterling, however, interest is calculated on the assumption of 365 days a year and is based on ACT/365 day count convention.

Instruments of Money Markets



CALL / NOTICE MONEY

TREASURY BILLS

COMMERCIAL PAPERS

REPURCHASE AGREEMENT

CERTIFICATE OF DEPOSIT

The Main instruments of Money Markets are Short Term in Nature.

Instruments of Money Market

Call money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call (Overnight.

Call Money

Notice Money

When money is borrowed or lent for more than a day and up to 14 days, it is **"Notice Money".**

Certificate of Deposit

A certificate of deposit (CD) is a relatively low-risk debt instrument purchased directly through a commercial bank or savings and loan institution.

Interbank Lending

CALL MONEY	Refers to deposits for a unspecified term on a day to day basis. Lender can call back the funds at any time, and they are repaid on the same day.
OVERNIGHT MONEY	Refers to money borrowed or loaned on a given banking day and is scheduled to be repaid on the next banking day.
WEEKEND MONEY	Refers to overnite money borrowed on last day of the week with repayment being scheduled for following Monday is called Weekend Money.
TERM MONEY	Refers to money loaned or termed for a fixed period such as a week or a month.
INTRADAY MONEY	Refers to money loaned and repaid on same day. Borrowing takes place in the morning of the business day, and repayment is scheduled for the same afternoon.

Instruments of Money Market

Treasury Bills

- T-bills are short-term securities that mature in one year or less from their issue date.
- They are issued with three-month, six-month and one-year maturities.
- They are issued at a discount to the face value, and on maturity the face value is paid to the holder.

Bills of Exchange

- Bills of exchange are similar to checks and promissory notes.
- They can be drawn by individuals or banks and are generally transferable by endorsements.
- It is written order used primarily in international trade that binds one party to pay a fixed sum of money to another party at a predetermined future date.

Instruments of Money Market

Commercial Papers

- Commercial paper is an unsecured and discounted promissory note issued to finance the short-term credit needs of large institutional buyers.
- Banks, corporations and foreign governments commonly use this type of funding.

Repurchase Agreement

- A repurchase agreement (Repo) is the sale of a security combined with an agreement to repurchase the same security at a higher price at a future date.
- For the party selling the security it is a repo.
- For the party on the other end of the transaction, it is a reverse repurchase agreement.