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Introduction

The purpose of our abstract is studying the global money markets and money as versions of the goods. In chapter 1 we cover general economic conditions for the use of money. The intent of this chapter is to introduce some of the functions of money. It is essential to understand these functions since the money markets carries out similar functions. Everybody use money and it is important to know «how it works».

Chapter 2 covers short-term debt instruments issued by some of the largest borrowers in the world—the U.S. Treasury and U.S. federal agencies. U.S. Treasury bills are considered among the safest and most liquid securities in the money market. Treasury bill yields serve as benchmark short-term interest rates for markets around the world. Another large borrower of short-term funds is a corporation using instruments such as commercial paper or short-term medium term notes. These instruments are the subject of this chapter too.

Chapter 2 describes short-term floating-rate securities. The term “floating-rate security” covers several different types of instruments with one common feature: the security’s coupon rate will vary over the life of the instrument. Approximately, 10% of publicly traded debt issued worldwide possesses a floating coupon. Floating-rate securities are the investment of choice for financial institutions whose funding costs are based on a short-term floating rate.

The activity of financial institutions in the money market involves an activity known as asset and liability management. We introduce the fundamental principles of asset and liability management in chapter 3. An appreciation of these concepts and tools is essential to an understanding of the functioning of the global money markets.

Chapter 3 describes why LIBOR is the very important interest rate. This chapter covers agency securities. These securities are not typically backed by the full faith and credit of the U.S. government, as is the case with Treasury bills. However, short-term agency securities are considered safer than other money market instruments except U.S. Treasury bills. We describe the role of the Federal National Mortgage Association in U.S. money market. Also we tell about cash management. So, let’s start…

Chapter 1

The General Economic Conditions for the Use of Money. Money and Money Substitutes

All of us know that a word of "money" means. But not everyone knows why money uses. We shall try to look at money from other point of view in this chapter. First we shall stop on general economic conditions for the use of money, and then we shall tell about functions of money and money substitutes.

Where the free exchange of goods and services is unknown, money is not wanted. In a state of society in which the division of labor was a purely domestic matter and production and consumption were consummated within the single household it would be just as useless as it would be for an isolated man. But even in an economic order based on division of labor, money would still be unnecessary if the means of production were socialized, the control of production and the distribution of the finished product were in the hands of a central body, and individuals were not allowed to exchange the consumption goods allotted to them for the consumption goods allotted to others.

The phenomenon of money presupposes an economic order in which production is based on division of labor and in which private property consists not only in goods of the first order (consumption goods), but also in goods of higher orders (production goods). In such a society, there is no systematic centralized control of production, for this is inconceivable without centralized disposal over the means of production. Production is "anarchistic." What is to be produced, and how it is to be produced, is decided in the first place by the owners of the means of production, who produce, however, not only for their own needs, but also for the needs of others, and in their valuations take into account, not only the use-value that they themselves attach to their products, but also the use-value that these possess in the estimation of the other members of the community. The balancing of production and consumption takes place in the market, where the different producers meet to exchange goods and services by bargaining together. The function of money is to facilitate the business of the market by acting as a common medium of exchange. [1, p.26]

Indirect exchange becomes more necessary as division of labor increases and wants become more refined. In the present stage of economic development, the occasions when direct exchange is both possible and actually effected have already become very exceptional. Nevertheless, even nowadays, they sometimes arise. Take, for instance, the payment of wages in kind, which is a case of direct exchange so long on the one hand as the employer uses the labor for the immediate satisfaction of his own needs and does not have to procure through exchange the goods in which the wages are paid, and so long on the other hand as the employee consumes the goods he receives and does not sell them. Such payment of wages in kind is still widely prevalent in agriculture, although even in this sphere its importance is being continually diminished by the extension of capitalistic methods of management and the development of division of labor.

The simple statement, that money is a commodity whose economic function is to facilitate the interchange of goods and services, does not satisfy those writers who are interested rather in the accumulation of material than in the increase of knowledge. Many investigators imagine that insufficient attention is devoted to the remarkable part played by money in economic life if it is merely credited with the function of being a medium of exchange; they do not think that due regard has been paid to the significance of money until they have enumerated half a dozen further "functions"—as if, in an economic order founded on the exchange of goods, there could be a more important function than that of the common medium of exchange. [1, p. 12]

Credit transactions are in fact nothing but the exchange of present goods against future goods. Frequent reference is made in English and American writings to a function of money as a standard of deferred payments. But the original purpose of this expression was not to contrast a particular function of money with its ordinary economic function, but merely to simplify discussions about the influence of changes in the value of money upon the real amount of money debts. It serves this purpose admirably. But it should be pointed out that its use has led many writers to deal with the problems connected with the general economic consequences of changes in the value of money merely from the point of view of modifications in existing debt relations and to overlook their significance in all other connections.

Particular attention has been devoted, especially in recent times, to the function of money *as a general medium of payment* and the functions of money as a *transmitter of value through time and space* may also be directly traced back to its function as medium of exchange.[1, p. 15]Indirect exchange divides a single transaction into two separate parts which are connected merely by the ultimate intention of the exchangers to acquire consumption goods. Sale and purchase thus apparently become independent of each other.

When an indirect exchange is transacted with the aid of money, it is not necessary for the money to change hands physically; a perfectly secure claim to an equivalent sum, payable on demand, may be transferred instead of the actual coins. In this by itself there is nothing remarkable or peculiar to money. What is peculiar, and only to be explained by reference to the special characteristics of money; is the extraordinary frequency of this way of completing monetary transactions.

In the first place, money is especially well adapted to constitute the substance of a generic obligation. Whereas the fungibility of nearly all other economic goods is more or less circumscribed and is often only a fiction based on an artificial commercial terminology, that of money is almost unlimited. Only that of shares and bonds can be compared with it. [1, p.26]

Technically, and in some countries legally as well, the transfer of a banknote scarcely differs from that of a coin. The similarity of outward appearance is such that those who are engaged in commercial dealings are usually unable to distinguish between those objects that actually perform the function of money and those that are merely employed as substitutes for them. The businessman does not worry about the economic problems involved in this; he is only concerned with the commercial and legal characteristics of coins, notes, checks, and the like. To him, the facts that banknotes are transferable without documentary evidence, that they circulate like coins in round denominations, that no fight of recovery lies against their previous holders, that the law recognizes no difference between them and money as an instrument of debt settlement, seem good enough reason for including them within the definition of the term *money,* and for drawing a fundamental distinction between them and cash deposits, which can be transferred only by a procedure that is much more complex technic ally and is also regarded in law as of a different kind. This is the origin of the popular conception of money by which everyday life is governed. No doubt it serves the purposes of the bank official, and it may even be quite useful in the business world at large, but its introduction into the scientific terminology of economics is most undesirable.

We may give the name *commodity money* to that sort of money that is at the same time a commercial commodity; and the name *fiat money* to money that comprises things with a special legal qualification. A third category may be called *credit* *money,* this being that sort of money which constitutes a claim against any physical or legal person. [1, p. 24]

The decisive characteristic of commodity money is the employment for monetary purposes of a commodity in the technological sense. For the present investigation, it is a matter of complete indifference what particular commodity this is; the important thing is that it is the commodity in question that constitutes the money, and that the money is merely this commodity. The case of fiat money is quite different.

And the last, money is not a free good. Those who need money are willing to pay for it and those who lend money expect to be compensated. The *interest* *rate* is the cost of money. If you put $1,000 in an account in a savings and loan that pays interest of 5% per year, you will earn $50 interest in one year. The savings and loan is paying you $50 for the use of your $1,000. Similarly, if you buy a $1,000 face value bond with a coupon rate of 5%, you earn $50 interest each year. The issuer is paying $50 interest each year for the use of your $1, 000. [6, p. 67]

So, the money is not wanted, where the free exchange of goods and services is unknown. Money would still be unnecessary if the means of production were socialized, the control of production and the distribution of the finished product were in the hands of a central body. But it cannot be in a modern society. The simple statement, that money is a commodity whose economic function is to facilitate the interchange of goods and services. But money carries out also other functions. These are function of money as a general medium of payment, and the functions of money as a transmitter of value through time and space. There are 3 categories of money: commodity money, fiat money, credit money. And the last - money is not a free good.

Chapter 2

The Global Money Markets. US Money Market

In this chapter the question will be the global money markets as component of a financial market. Also we shall pay attention to the US money market.

So, the money market is a market in which the cash requirements of market participants who are *long* cash are met along with the requirements of those that are *short* cash. [5, p.9] This is identical to any financial market; the distinguishing factor of the money market is that it provides for only short-term cash requirements. The market will always, without fail, be required because the needs of long cash and short cash market participants are never completely synchronized. The participants in the market are many and varied, and large numbers of them are both borrowers and lenders at the same time. They include:

* the sovereign authority, including the central government (“Treasury”),
* as well as government agencies and the central bank or *reserve bank*;
* financial institutions such as the large integrated investment banks,
* commercial banks, mortgage institutions, insurance companies, and
* finance companies;
* corporations of all types;
* individual private investors, such as high net-worth individuals and
* small savers;
* intermediaries such as money brokers, banking institutions, etc.;
* infrastructure of the marketplace, such as derivatives exchanges.

The money market is traditionally defined as the market for financial assets that have original maturities of one year or less. In essence, it is the market for short-term debt instruments. Financial assets traded in this market include such instruments as U.S. Treasury bills, commercial paper, some medium-term notes, bankers acceptances, federal agency discount paper, most certificates of deposit, repurchase agreements, floating-rate agreements, and federal funds. The scope of the money market has expanded in recent years to include securitized products such mortgage-backed and asset-backed securities with short average lives. These securities, along with the derivative contracts associated with them, are the subject of this study.

The workings of the money market are largely invisible to the average retail investor. The reason is that the money market is the province of relatively large financial institutions and corporations. Namely, large borrowers (e.g., U.S. Treasury, agencies, money center banks, etc.) seeking short-term funding as well as large institutional investors with excess cash willing to supply funds short-term. Typically, the only contact retail investors have with the money market is through *money market mutual* *funds*, known as *unit trusts* in the United Kingdom and Europe.

Money market mutual funds are mutual funds that invest only in money market instruments. There are three types of money market funds: (1) general money market funds, which invest in wide variety of short-term debt products; (2) U.S. government short-term funds, which invest only in U.S. Treasury bills or U.S. government agencies; and (3) short-term municipal funds. Money market mutual funds are a popular investment vehicle for retail investors seeking a safe place to park excess cash. [5, p.20] In Europe, unit trusts are well-established investment vehicles for retail savers; a number of these invest in short-term assets and thus are termed money market unit trusts. Placing funds in a unit trust is an effective means by which smaller investors can leverage off the market power of larger investors. In the UK money market, unit trusts typically invest in deposits, with a relatively small share of funds placed in money market paper such as government bills or certificates of deposit. Investors can invest in money market funds using one-off sums or save through a regular savings plan.

A money market exists in virtually every country in the world, and all such markets exhibit the characteristics we describe in this study to some extent. For instance, they provide a means by which the conflicting needs of borrowers and lenders can achieve equilibrium, they act as a conduit for financing of all maturities between one day and one year, and they can be accessed by individuals, corporations, and governments alike.

In addition to national domestic markets, there is the international cross-border market illustrated by the trade in *Eurocurrencies[[1]](#footnote-1)*. [5, p. 10] Of course, there are distinctions between individual country markets, and financial market culture will differ. For instance, the prevailing financial culture in the United States and United Kingdom is based on a secondary market in tradable financial assets, so we have a developed and liquid bond and equity market in these economies. While such an arrangement also exists in virtually all other countries, the culture in certain economies such as Japan and (to a lesser extent) Germany is based more on banking relationships, with banks providing a large proportion of corporate finance. The differences across countries are not touched upon in this study; rather, it is the similarities in the type of instruments used that is highlighted.

A security is an instrument that represents ownership in an asset or debt obligation. Securities are classified as either money market securities, capital market securities, or derivative securities.

***Money market securities*** are short-term indebtedness. By “short term” we usually imply an original maturity of one year or less. The most common money market securities are Treasury bills, commercial paper, negotiable certificates of deposit, and bankers acceptances. [6, p.44]

***Treasury bills*** (*T-bills*) are short-term securities issued by the U.S. government; they have original maturities of either four weeks, three months, or six months. [6, p.44] Unlike other money market securities, T-bills carry no stated interest rate. Instead, they are sold on a ***discounted*** ***basis***: Investors obtain a return on their investment by buying these securities for less than their face value and then receiving the face value at maturity. T-Bills are sold in $10,000 denominations; that is, the T-Bill has a face value of $10,000.

***Commercial paper*** is a promissory note—a written promise to pay—issued by a large, creditworthy corporation. These securities have original maturities ranging from one day to 270 days and usually trade in units of $100,000. [6, p.45] Most commercial paper is backed by bank lines of credit, which means that a bank is standing by ready to pay the obligation if the issuer is unable to. Commercial paper may be either interest – bearing or sold on a discounted basis.

***Certificates of deposit*** (CDs) are written promises by a bank to pay a depositor. Nowadays they have original maturities from six months to three years. [6, p.45] ***Negotiable certificates of deposit*** are CDs issued by large commercial banks that can be bought and sold among investors. Negotiable CDs typically have original maturities between one month and one year and are sold in denominations of $100,000 or more. Negotiable certificates of deposit are sold to investors at their face value and carry a fixed interest rate. On the maturity date, the investor is repaid the amount borrowed, plus interest.

***Eurodollar certificates of deposit*** are CDs issued by foreign branches of U.S. banks, and ***Yankee certificates of deposit*** are CDs issued by foreign banks located in the United States. [6, p.45] Both Eurodollar CDs and Yankee CDs are denominated in U.S. dollars. In other words, interest payments and the repayment of principal are both in U.S. dollars.

***Bankers’ acceptances*** are short-term loans, usually to importers and exporters, made by banks to finance specific transactions. An acceptance is created when a draft (a promise to pay) is written by a bank’s customer and the bank “accepts” it, promising to pay. [6, p.46] The bank’s acceptance of the draft is a promise to pay the face amount of the draft to whoever presents it for payment. The bank’s customer then uses the draft to finance a transaction, giving this draft to her supplier in exchange for goods. Since acceptances arise from specific transactions, they are available in a wide variety of principal amounts. Typically, bankers’ acceptances have maturities of less than 180 days. Bankers’ acceptances are sold at a discount from their face value, and the face value is paid at maturity. Since acceptances are backed by both the issuing bank *and* the purchaser of goods, the likelihood of default is very small.

Money market securities are backed solely by the issuer’s ability to pay. With money market securities, there is no ***collateral***; that is, no item of value (such as real estate) is designated by the issuer to ensure repayment. The investor relies primarily on the reputation and repayment history of the issuer in expecting that he or she will be repaid.

Markets in the United States [6, p.53-57]:

1. Equity Markets

In the United States, there are two national stock exchanges: (1) the New York Stock Exchange (NYSE), commonly called the “Big Board,” and (2) the American Stock Exchange (AMEX or ASE), also called the “Curb.” National stock exchanges trade stocks of not only U.S. corporations but also non-U.S. corporations.

1. Stock Exchanges

The regional stock exchanges compete with the NYSE for the execution of smaller trades.

1. OTC Market

The OTC market is called the market for unlisted stocks. As explained previously, technically while there are listing requirements for exchanges, there are also listing requirements for the Nasdaq National and Small Capitalization OTC markets. There are three parts to the OTC market: two under the aegis of NASD (the Nasdaq markets) and a third market for truly unlisted stocks, the non-Nasdaq OTC markets.

1. Stock Market Indicators

The most commonly quoted stock market indicator is the Dow Jones Industrial Average (DJIA). Other stock market indicators cited in the financial press are the Standard & Poor’s 500 Composite (S&P 500), the New York Stock Exchange Composite Index (NYSE Composite), the Nasdaq Composite Index, and the Value Line Composite Average (VLCA).

1. Bond Markets

The bond trading that does take place on exchanges consists primarily of small orders, whereas bond trading in the OTC market is for larger—sometimes huge—blocks of bonds, purchased by institutional investors. The three broad-based bond market indexes most commonly used by institutional investors are the Lehman Brothers U.S. Aggregate Index, the Salomon Smith Barney (SSB) Broad Investment- Grade Bond Index (BIG), and the Merrill Lynch Domestic Market Index.

1. Options and Futures Markets

The first formal options market was the ***Chicago Board Options Exchange*** (CBOE). Soon after, several exchanges introduced optionscontracts to their “product lines.” Now options are traded on suchexchanges as the CBOE, the Chicago Board of Trade (CBOT), the PacificStock Exchange, the Philadelphia Stock Exchange, and the AmericanStock Exchange.

1. Money Markets

Money market securities are not traded in a physical location; rather these securities are traded over-the-counter through banks and dealers that are networked together by telephone and computer lines. These intermediaries bring together buyers and sellers from around the world. In the United States, most trading is centered on large banks (called ***money center banks***) located in the major financial centers of the country. Many banks and dealers specialize in specific instruments, such as commercial paper or bankers’ acceptances.

The United States has a central monetary authority known as the Federal Reserve System. The ***Federal Reserve System*** (often referred to as the “Fed”) acts as the U.S. central bank, much like the Bank of England and the Bank of France are central banks in their respective countries.

The role of a central bank is to carry out monetary policy that serves the best interests of the country’s economic well-being. ***Monetary policy*** is the set of tools that a central bank can use to control the availability of loanable funds. These tools can be used to achieve goals for the nation’s economy. Along with the U.S. Treasury, the Fed determines policies that affect employment and prices.

The Federal Reserve System is comprised of 12 district banks, with the Federal Reserve Board of Governors overseeing the activities of the district banks. The members of the Board are appointed by the President of the United States and confirmed by the U.S. Senate, and each serves a term of 14 years, with terms staggered through time. The president also appoints the chairman of the board from among the members on the board. The chairman serves in this capacity for a term of four years. [6, p.64]

The Federal Reserve District Banks are not-for-profit institutions. Their responsibilities include (1) handling the vast majority of checkclearing in the United States, (2) issuing money, and (3) acting as the bankers’ bank, accepting deposits from other financial institutions. [6, p.65] Financial managers and investors are interested in the supply and demand for money because it is the interaction of supply and demand that ultimately affects the interest rates paid to borrow funds and the amount of interest earned on investing funds. The demand for money is determined by the availability of investment opportunities. The supply of money is determined, in large part, by the actions of a nation’s central bank.

The decisions of the Fed affect the money supply of the United States. The ***money supply*** consists of cash and cash-like items. In fact, there are different definitions of the money supply, depending on the cash-like items you include. For example, the most basic definition of money supply, *M1*, consists of [6, p.66]:

* cash (currency and bills) in circulation,
* demand deposits (non-interest earning deposits at banking institutions
* that can be withdrawn on demand),
* other deposits that can be readily withdrawn using checks, and
* travelers’ checks.

A broader definition of money supply is *M2*, which consists of everything in M1, plus [6, p.66]:

* savings deposits,
* small denomination time deposits,
* money market mutual funds, and
* money market deposit accounts.

A still broader definition of money supply is *M3*, which consists of everything in M2, plus [6, p.67]:

* large denomination time deposits,
* term repurchase agreements issued by commercial banks and thrift institutions, term Eurodollars held by U.S. residents, and
* institution-owned balances in money market funds.

Thus, the money market is a market in which the cash requirements of market participants who are *long* cash are met along with the requirements of those that are *short* cash. The money market is traditionally defined as the market for financial assets that have original maturities of one year or less. In essence, it is the market for short-term debt instruments. Financial assets traded in this market include such instruments as U.S. Treasury bills, commercial paper, some medium-term notes, bankers acceptances, federal agency discount paper, most certificates of deposit, repurchase agreements, floating-rate agreements, and federal funds.

There are three types of money market funds: (1) general money market funds; (2) U.S. government short-term funds; and (3) short-term municipal funds. A money market exists in virtually every country in the world, and all such markets exhibit the characteristics we described in this chapter to some extent. In the UK money market, unit trusts typically invest in deposits, with a relatively small share of funds placed in money market paper such as government bills or certificates of deposit. Economies such as Japan and Germany are based more on banking relationships, with banks providing a large proportion of corporate finance.

Money market securities are short-term indebtedness. These are treasury bills (T-bills), commercial paper, certificates of deposit (CDs), Eurodollar certificates of deposit, bankers’ acceptances.

U.S. financial sector divided on: equity markets, stock exchanges, OTC market, stock market indicators, bond markets, options and futures markets, money markets. The United States has a central monetary authority known as the Federal Reserve System.

Monetary policy is the set of tools that a central bank can use to control the availability of loanable funds. These tools can be used to achieve goals for the nation’s economy. Along with the U.S. Treasury, the Fed determines policies that affect employment and prices.

Chapter 3

Money Management. Cash Management for Finance Managers

Any firm can deal in government securities, but when the Federal Reserve engages in trades of Treasuries in order to implement monetary policy, the New York Fed’s Open Market Desk will deal directly only with dealers that it designates as primary or recognized dealers. The primary dealer system was established in 1960 and is designed to ensure that firms requesting status as primary dealers have adequate capital relative to positions assumed in Treasury securities and that their trading volume in Treasury securities is at a reasonable level. The Federal Reserve requires primary dealers to participate in both open market operations and Treasury auctions. In addition, primary dealers provide market information and analysis which may be useful to the Open Market Desk in the implementation of monetary policy. Primary dealers include diversified and specialized firms, money center banks, and foreign-owned financial entities. [5, p.44]

Primary dealers trade with the investing public and with other dealer firms. When they trade with each other, it is through intermediaries known as interdealer brokers. Dealers leave firm bids and offers with interdealer brokers who display the highest bid and the lowest offer in a computer network tied to each trading desk and displayed on a monitor.

The dealer responding to a bid or offer by “hitting” or “taking” pays a commission to the interdealer broker. [5, p.45] The size and prices of these transactions are visible to all dealers at once. The fees charged are negotiable and vary depending on transaction volume.

Six interdealer brokers handle the bulk of daily trading volume. They include Cantor, Fitzgerald Securities, Inc.; Garban Ltd.; Liberty Brokerage Inc.; RMJ Securities Corp.; Hilliard Farber & Co. Inc.; and Tullett & Tokyo Securities Inc. These six firms serve the primary government dealers and approximately a dozen other large government dealers aspiring to be primary dealers. [5, p.46]

Dealers use interdealer brokers because of the speed and efficiency with which trades can be accomplished. With the exception of Cantor, Fitzgerald Securities Inc., interdealer brokers do not trade for their own account, and they keep the names of the dealers involved in trades confidential. The quotes provided on the government dealer screens represent prices in the “inside” or “interdealer” market.

We have already learned U.S. Treasury bills are very important instruments in the money market, there is some evidence which suggests that bill yields no longer serve as benchmark instruments from which other money market instruments are priced. LIBOR is the interest rate which major international banks offer each other on Eurodollar certificates of deposit (CD) with given maturities. The maturities range from overnight to five years. So, references to “3-month LIBOR” indicate the interest rate that major international banks are offering to pay to other such banks on a CD that matures in three months. Eurodollar CDs pay simple interest at maturity on an ACT/360 basis. [5, p.35] LIBOR serves as a pricing reference for a number of widely traded financial products and derivatives (e.g., floaters, swaps, structured notes, etc.).

Because of LIBOR’s importance in the global money markets, it is instructive to examine the relationship between Treasury bill yields and LIBOR. We expect LIBOR rates to be higher than the yields on bills of the same maturity because investors in Eurodollars CDs are exposed to default risk.

U.S. Treasury securities and the U.S. dollar are considered “safe havens” in times of crisis, regardless of their underlying causes. During times of turmoil, the resulting “flight to quality” widens the spread between LIBOR rates and T-bill rates.

U.S. money market is managed by U.S. government agencies. [5, p.54] U.S. government agency securities can be classified by the type of issuer—those issued by federal agencies and those issued by government sponsored enterprises. Moreover, U.S. government agencies that provide credit for the housing market issue two types of securities: debentures and mortgage-backed/asset-backed securities.

*Federal agencies* are fully owned by the U.S. government and have been authorized to issue securities directly in the marketplace. *Government sponsored enterprises* (GSEs) are privately owned, publicly chartered entities. [5, p.56] They were created by Congress to reduce the cost of capital for certain borrowing sectors of the economy deemed to be important enough to warrant assistance. The entities in these privileged sectors include farmers, homeowners, and students. GSEs issue securities directly in the marketplace.

The Federal National Mortgage Association (“Fannie Mae”) is a GSE chartered by the Congress of the United States in 1938 to develop a secondary market for residential mortgages. [5, p.70] Fannie Mae buys home loans from banks and other mortgage lenders in the primary market and either holds the mortgages until they mature or issues securities backed by pools of these mortgages. Fannie Mae’s housing mission is overseen by the U.S. Department of Housing and Urban Development (HUD), and its safety and soundness is overseen by the Office of Federal Housing Enterprise Oversight (OFHEO). Although it is controversial, Fannie Mae maintains a direct line of credit with the U.S. Treasury.

If a corporation needs short-term funds, it may attempt to acquire funds via bank borrowing. One close substitute to bank borrowing for larger corporations with strong credit ratings is commercial paper. Commercial paper is a short-term promissory note issued in the open market as an obligation of the issuing entity. [2, p.40] Commercial paper is sold at a discount and pays face value at maturity. The discount represents interest to the investor in the period to maturity. Although some issues are in registered form, commercial paper is typically issued in bearer form.

Although commercial paper, as noted, is the largest sector of the money market, there is relatively little trading in the secondary market. The reason being is that most investors in commercial paper follow a “buy and hold” strategy. This is to be expected because investors purchase commercial paper that matches their specific maturity requirements. Any secondary market trading is usually concentrated among institutional investors in a few large, highly rated issues. If investors wish to sell their commercial paper, they can usually sell it back to the original seller either dealer or issuer.

The largest players in the global money markets are financial institutions — namely depository institutions (i.e., commercial banks, thrifts, and credit unions), insurance companies, and investment banks. [3, p.89] These institutions are simultaneously among the biggest buyers and issuers of money markets instruments. Moreover, there are certain short-term debt instruments peculiar to financial institutions such as certificates of deposits, federal funds, bankers acceptances, and funding agreements.

Depository institutions are required to hold reserves to meet their reserve requirements. The level of the reserves that a depository institution must maintain is based on its average daily deposits over the previous 14 days. To meet these requirements, depository institutions hold reserves at their district Federal Reserve Bank. These reserves are called *federal funds*. [5, p.100]

Because no interest is earned on federal funds, a depository institution that maintains federal funds in excess of the amount required incurs an opportunity cost of the interest forgone on the excess reserves. Correspondingly, there are also depository institutions whose federal funds are short of the amount required. The federal funds market is where depository institutions buy and sell federal funds to address this imbalance. Typically, smaller depository institutions (e.g., smaller commercial banks, some thrifts, and credit unions) almost always have excess reserves while money center banks usually find themselves short of reserves and must make up the deficit. The supply of federal funds is controlled by the Federal Reserve through its daily open market operations.

Most transactions involving federal funds last for only one night; that is, a depository institution with insufficient reserves that borrows excess reserves from another financial institution will typically do so for the period of one full day. Because these reserves are loaned for only a short time, federal funds are often referred to as “overnight money.” [5, p.101]

The interest rate at which federal funds are bought (borrowed) by depository institutions that need these funds and sold (lent) by depository institutions that have excess federal funds is called the federal funds rate. The federal funds is a benchmark short-term interest. Indeed, other short-term interest rates (e.g., Treasury bills) often move in tandem with movements in the federal funds rate. The rate most often cited for the federal funds market is known as the *effective federal funds rate*. [5, p.101]

But, coming back to corporations, it is necessary to note, that managers base decisions about investing in short-term projects on judgments about future cash flows, the uncertainty of those cash flows, and the opportunity costs of the funds to be invested.

Cash flows *out of* a firm as it pays for the goods and services it purchases from others. Cash flows *into* the firm as customers pay for the goods and services they purchase. When we refer to ***cash***, we mean the amount of cash and cash-like assets—currency, coin, and bank balances. [6, p.642] When we refer to ***cash management***, we mean management of cash inflows and outflows, as well as the stock of cash on hand.

The primary players in the global money markets are banking and financial institutions which include investment banks, commercial banks, thrifts and other deposit and loan institutions. Banking activity and the return it generates reflects the bank’s asset allocation policies. Asset allocation decisions are largely influenced by the capital considerations that such an allocation implies and the capital costs incurred. The cost of capital must, in turn, take into account the *regulatory capital* implications of the positions taken by a trading desk. [5, p.307] Therefore, money market participants must understand regulatory capital issues regardless of the products they trade or they will not fully understand the cost of their own capital or the return on its use.

The rules defining what constitutes capital and how much of it to allocate are laid out in the Bank for International Settlements (BIS) guidelines, known as the *Basel rules*. [5, p.310] Although the BIS is not a regulatory body per se and its pronouncements carry no legislative weight, to maintain investors and public confidence national authorities endeavor to demonstrate that they follow the Basel rules at a minimum.

So, any firm can deal in government securities; the primary dealer system was established in 1960. Primary dealers include diversified and specialized firms, money center banks, and foreign-owned financial entities. The dealer responding to a bid or offer by “hitting” or “taking” pays a commission to the interdealer broker. Only six interdealer brokers handle the bulk of daily trading volume.

Dealers use interdealer brokers because of the speed and efficiency with which trades can be accomplished. They use LIBOR. LIBOR is the interest rate which major international banks offer each other on Eurodollar certificates of deposit (CD) with given maturities.

U.S. money market is managed by U.S. government agencies. *Federal agencies* are fully owned by the U.S. government and have been authorized to issue securities directly in the marketplace.

The largest players in the global money markets are financial institutions — namely depository institutions (i.e., commercial banks, thrifts, and credit unions), insurance companies, and investment banks. Most transactions involving federal funds last for only one night.

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Conclusion

So, we have considered the global money markets. It is possible to draw the following conclusions. The simple statement, that money is a commodity whose economic function is to facilitate the interchange of goods and services. But money carries out also other functions. These are function of money as a general medium of payment, and the functions of money as a transmitter of value through time and space. There are 3 categories of money: commodity money, fiat money, credit money. And the last - money is not a free good.

The money market is a market in which the cash requirements of market participants who are *long* cash are met along with the requirements of those that are *short* cash. The money market is traditionally defined as the market for financial assets that have original maturities of one year or less. In essence, it is the market for short-term debt instruments. Financial assets traded in this market include such instruments as U.S. Treasury bills, commercial paper, some medium-term notes, bankers acceptances, federal agency discount paper, most certificates of deposit, repurchase agreements, floating-rate agreements, and federal funds.

There are three types of money market funds: (1) general money market funds; (2) U.S. government short-term funds; and (3) short-term municipal funds. A money market exists in virtually every country in the world, and all such markets exhibit the characteristics we described in this chapter to some extent.

Money market securities are short-term indebtedness. These are treasury bills (T-bills), commercial paper, certificates of deposit (CDs), Eurodollar certificates of deposit, bankers’ acceptances.

U.S. financial sector divided on: equity markets, stock exchanges, OTC market, stock market indicators, bond markets, options and futures markets, money markets. The United States has a central monetary authority known as the Federal Reserve System.

Monetary policy is the set of tools that a central bank can use to control the availability of loanable funds. These tools can be used to achieve goals for the nation’s economy. Along with the U.S. Treasury, the Fed determines policies that affect employment and prices.

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1. A Eurocurrency is a currency that is traded outside of its national border, and can be any currency rather than just a European one. [↑](#footnote-ref-1)