Money Markets

Money markets provide economic stability and short-term liquidity with participants lending and borrowing short-term, high-quality debt securities with maturities of one year or less.

By using organized exchanges, governments, banks, and other large institutions sell short-term securities to fund short-term cash flow needs, whilst allowing individual investors to invest in a low-risk setting.

Instruments traded (mostly via OTC) are, among others:

- Treasury Bills (T-bills, with maturities of 1, 3, 6, 12 months) are considered the safest instruments. In the United States, T-bills are issued as zero-coupon bonds (i.e. at discount to face value) and backed by a full government guarantee. Other sovereigns also issue comparable instruments.
- Certificate of Deposits (CDs) are issued directly by commercial banks (thereby, covered by the national deposit insurance) and come with maturities from 3 months to 5 years in any denomination. Offered with fixed interest, a penalty is due if withdrawn prior to maturity.
- Commercial Papers (CPs) are unsecured loans (maturities less than 1 year) issued as zeros with a discount by large, top credit-quality institutions or corporations to finance short-term cash flow needs (e.g. inventory, accounts payables). Offered in denominations of US$100,000 and above, individuals can invest in the CP market through money market funds.
- Repurchase Agreements (repo) is a short-term form of borrowing (from overnight up to 30 days or more) by selling a security with an agreement to repurchase it at a higher price at a later date. Foremost used by financial institutions, also central banks buy repurchase agreements to regulate money supply and bank reserves.

Whilst on the capital markets longer-term funding is supplied by bonds and equities, the core of the money market consists of interbank lending (banks borrowing and lending to each other using CPs, repos, or similar). As instruments are commonly not secured by collateral, a lender looks to a borrower's creditworthiness to assess repayment probabilities Often they are benchmarked to (i.e. priced by reference to) the London Interbank Offered Rate (LIBOR) for the appropriate term and currency.

LIBOR refers to the interest rates across several currencies that UK banks charge other financial institutions for short-term loans (maturity 1 day to 1 year). It acts as a benchmark for short-term interest rates to price securities and structures, such as currency swaps, interest rate swaps, or mortgages. Published daily by the European Money Markets Institute, the EURIBOR is the pendant to the LIBOR for EUR only. – With LIBOR being replaced as of late 2021, multiple benchmarks have emerged, among them the Secured Overnight Financing Rate (SOFR), a Bloomberg index or else.

Regularly, finance institutions fund themselves by issuing Asset-Backed CPs (ABCPs), secured by the pledge of eligible assets (e.g. auto loans, credit card receivables, mortgage loans, mortgage-backed securities). Large corporations with a strong credit rating, on the other hand, issue CPs on their own credit. Other large corporations arrange for banks to issue CPs on their behalf.

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	MONEY MARKETS	CAPITAL MARKETS
FOCUS	LIQUIDITY	SAVINGS / INVESTMENTS
MATURITY	SHORT-TERM	MEDIUM- / LONG-TERM
YIELD	LOWER	HIGHER
RISK	LOWER	HIGHER

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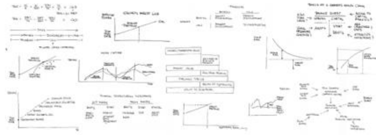

Corporate Finance Concepts

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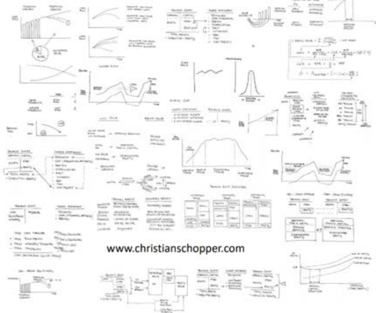

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