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# Money Market vs. Commodity Market - GK Notes for Banking & SSC Exams

Topics including money market and commodity market have been frequently asked in many competitive exams. These are comparatively easier topics to understand and help in scoring better. Here we are discussing the main points to remember about money market and commodity market including their basic introduction, major participants and differences.

Money market is a part of a financial market where short term borrowings can be issued. This kind of market includes assets that deal with short term borrowing, lending, buying and selling. Whereas, commodity market is a physical or virtual marketplace for buying, selling and trading raw or primary products. Read this article to know in detail about money market and commodity market.

## Money Market - An Introduction

- The money market is a key component of the financial system as it is the basis of the monetary operations undertaken by RBI to attain its monetary policy objectives.
- It is **one of the primary mechanisms through which the Central Bank (RBI) influences liquidity rate** and the general level of interest rates in the economy.
- This market is **for short term funds with their maturity ranging from 1 day to 1 year** and include financial instruments that are considered to be close substitutes of money.
- Instruments of money market have the characteristics of liquidity (quick conversion into money), minimum transaction cost and no loss in value.





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## Functions of Money Market

- It functions as a **wholesale debt market for low risk, highly liquid, short term instruments.**
- It performs the crucial role of providing a mechanism to even out short term liquidity, surpluses and deficits and in this process facilitates the working of monetary policy.

## Main participants in Money Market

- Mostly, **Governments, banks and financial institutions dominate the money market.**
- The Government is an active player in the money market and in most of the economies **it is the biggest borrower in this market.** Government securities and Treasury Bills are securities issued by the RBI on behalf of the Government of India to meet its borrowings for financing fiscal deficit.
- Apart from functioning as a banker to the government, the Central Bank (RBI) also regulates the money market and issues guidelines to govern the money market operations.
- Another dominant player in the money market is the banking sector. Banks mobilize deposits of savers in lending to investors of the economy. This process is called credit creation. However, banks are not allowed to use the entire amount for extending credit for investment. They are required to maintain minimum liquid and cash reserve ratios known as Statutory Liquid Ratio (SLR) and Cash Reserve Ratio (CRR).
- Other players like financial institutions, corporate, mutual funds, Foreign Institutional Investors etc. also are players in the money market and make transaction in the money market to fulfill their respective financial deficits and short comings.

## Commodity Market - An Introduction

- A **commodity is an economic good, tradable good, product or an article.** Commodities can be perishable or non-perishable. One of the most important

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characteristic of a commodity is that **its price is determined as a function of its market as a whole.**

- A commodity market can be defined as an article, a product or material that is bought and sold in an established market between willing buyers and sellers.
- Every good or commodity that is produced has to come to a market place where it can be bought or sold. It is in this market place that all the elements of commerce will come together to settle a price at which the commodity will get traded.
- In order for a commodity market to be established, the consensus on the variations in the product that make it acceptable for one purpose or another must be very broad.
- Such goods are raw or partly refined materials whose value mainly reflects the costs of finding, gathering, or harvesting them; they are traded for processing or incorporation into final goods. Crude oil, rubber, cotton, grains, metals and other minerals are few examples.

## Functions of Commodity Market

- The market functions as a **price discovery mechanism, prices being determined by the supply of and demand for the commodity.** The prices are discovered through an auction mechanism such that sellers asking for a certain price, and buyers offering them a price, come around to settling upon one mutually agreeable price.

## Main participants in Commodity Market

- The **two main participants in a commodity market are the buyers and sellers.** They meet each other in the market, with sellers representing the supply side and buyers representing the demand side of this market.
- The trading of commodities in commodity markets consists of direct physical trading (spot trading) and derivatives trading.
- A market in which goods are sold for cash and delivered immediately is called the physical market. Deals in these markets are immediately effective. The physical market is





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also known as the **cash market or spot market**, because prices are settled in cash on the spot at current market prices, as opposed to forward prices.

- **Spot prices can indicate market expectations of future price movements in various ways**, depending on the item being traded.
- For a non-perishable commodity like good, spot price reflects market expectations of future price movements. In theory, the difference in spot and forward prices should be equal to the finance charges, plus any earnings due to the holder of the commodity, according to the cost of carry mode.
- A perishable commodity does not allow such arbitrage - the cost of storage is effectively higher than the expected future price of the commodity. As a result, spot prices reflect current supply and demand, rather than the future price movements. **Spot prices, therefore, turn out to be quite volatile and move independently from forward prices.**

*These are the major points to remember about money market and commodity market. To know more about similar scoring topics for general awareness, finance and economics, you can go through the posts mentioned below.*

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