Special Open Market Operations by RBI

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Why in News

Recently, the **Reserve Bank of India (RBI)** has announced several measures to ensure orderly market conditions and smooth financial conditions.

> These measures include two more tranches of **special Open Market Operations** (OMOs) in bonds and a **hike in the Held-To-Maturity (HTM) limit** under the **Statutory Liquidity Ratio (SLR)** for banks.

Key Points

- The move has been termed as **'Operation Twist'.**
  - Operation Twist is the name given to a **USA Federal Reserve monetary policy** operation, which involves the purchase and sale of government securities to boost the economy by bringing down long-term interest rates. It is now being used for **similar measures taken by RBI** in Indian context as well.
- **OMOs:** RBI will conduct **additional special open market operations** for an aggregate amount of Rs. 20,000 crore.
  - RBI conducted **OMOs in March** as well.

Open Market Operations

- Open Market Operations is the **simultaneous sale and purchase of government securities and treasury bills by RBI.**
- The objective of OMO is to **regulate the money supply** in the economy.
- RBI carries out the OMO **through commercial banks** and does not directly deal with the public.

- OMO is one of the **quantitative tools** that RBI uses to **smoothen the liquidity** conditions through the year and minimise its impact on the interest rate and inflation rate levels.

    Quantitative tools control the extent of money supply by changing the Cash Reserve Ratio (CRR), or bank rate or open market operations. Qualitative tools include persuasion by the Central bank in order to make commercial banks discourage or encourage lending which is done through moral suasion, margin requirement, etc.

- **Term Repo Operations:** RBI will also conduct **term repo operations** for an aggregate amount of Rs. 1,00,000 crore at the **prevailing** repo rate in the middle of September **to ease liquidity pressures on the market.**
    - In order to reduce the cost of funds, banks that had availed of funds under **Long-Term Repo Operations** (LTROs) may exercise an option of reversing these transactions before maturity.

        LTRO is a tool that lets banks borrow one to three-year funds from the RBI at the repo rate, by providing government securities with similar or higher tenure as collateral.
    - Thus, the banks may reduce their interest liability by returning funds taken at the repo rate prevailing at that time (5.15%) and **availing funds at the current repo rate of 4%.**
- **Increase in HTM limit**: RBI raised the limit on bonds held-to-maturity (HTM) to 22% from 19.5% of Net Demand and Time Liabilities (NDTL). This means banks will have room to buy more bonds without bothering about short-term fluctuations in yields.

    HTM securities are the debt securities acquired with the intent to keep it until **maturity.**

Key Terms

- **Repo Rate:** It is the rate at which RBI lends money to **commercial banks.**
- **Government Securities (G-Sec):** It is a tradable instrument issued by the central government or state governments.

    Short term G-secs (with original maturities of less than one year) are called **Treasury Bills.** Long term G-secs (with original maturities of more than one year) or long term are called **Government Bonds or Dated Securities.** Treasury Bills are not issued by State Governments while Government Bonds or Dated securities are issues both by State and Central Governments.
- **Net Demand and Time Liabilities (NDTL):** It is the difference between the sum of demand and time liabilities (deposits) of a bank (with the public or the other bank) and the deposits in the form of assets held by the other banks.

Way Forward

- The steps by RBI will definitely ensure **orderly functioning of the financial market,** as the market is facing a setback due to the global financial crisis amidst **Covid-19 pandemic.**
- The six- month **moratorium on repayment of debt** announced by RBI beginning 1st March, 2020 to help businesses and individuals tide over the financial problems on account of disruption in normal business activities ended on 31st August 2020.
    - This may adversely affect the small businesses that are facing financial issues due to Covid-19 pandemic and **lockdown.**
    - Recently, RBI announced use of **Dynamic Stochastic General Equilibrium (DSGE) model** to provide an **assessment of the likely impact of Covid-19** and the **subsequent lockdown** on the Indian economy.
- Coupled with the **recently announced GDP contraction by 23.9%,** the end of six-month moratorium will adversely impact the market. Tackling the financial health of the country hit by **Non Performing Assets** (NPAs), **bank frauds** and **economic setbacks by Covid-19**, as mentioned in the **Annual report of RBI**, will need a whole set of monetary reforms. Conducting market operations as required through a variety of instruments is one of them.

Source: IE