Open Market Operations by RBI

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Why in News

The **Reserve Bank of India** (RBI) has decided to conduct **simultaneous purchase and sale of government securities (G-Sec)** under **Open Market Operations (OMOs)** for an amount of Rs. 10,000 crore each.

Key Points

- **About:**

  Simultaneous purchase and sale of government securities under OMOs, popularly known as **operation twist**, involves purchasing G-Sec of longer maturities and selling equal amounts of G-Sec of shorter maturities.

- **Open Market Operations:**
    - **Meaning:** Open Market Operations **refers to buying and selling of bonds issued by the Government** in the open market.
    - **One of the Quantitative Tools:** 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.
    - **Impact on Money Supply:**
        - When **RBI buys a Government bond** in the open market, it pays for it by giving a cheque. This cheque increases the total amount of reserves in the economy and thus **increases the money supply.**
        - **Selling of a bond by RBI** (to private individuals or institutions) **leads to reduction in quantity of reserves and hence the money supply.**
    - **Two Types of OMOs:** Outright and Repo.
        - **Outright OMOs are permanent in nature:** when the central bank buys these securities (thus injecting money into the system), it is **without any promise to sell them later.** Similarly, when the central bank sells these securities (thus withdrawing money from the system), it is without any promise to buy them.
        - **Repo:**
            - This is a type of operation in which when the central bank buys the security, the **agreement of purchase also has specification about date and price of resale of this security.** This type of agreement is called a **repurchase agreement or repo.** The interest rate at which the money is lent in this way is called the **repo rate.**
            - Similarly, instead of outright sale of securities the **central bank may sell the securities through an agreement** which has a specification about the date and price at which it will be repurchased. This type of agreement is called **a reverse repurchase agreement or reverse repo.** The rate at which the money is withdrawn in this manner is called the **reverse repo rate.**
            - The Reserve Bank of India **conducts repo and reverse repo operations** at various maturities: overnight, 7-day, 14- day, etc. These types of operations have now become the **main tool of monetary policy of the Reserve Bank of India.**

Government Securities

- A G-Sec is **a tradable instrument** issued by the central government or state governments. It **acknowledges the Government's debt obligation.**
- **Short term securities** (with original maturities of less than one year) are usually called **Treasury Bills.**
- **Long term securities** (with original maturities of more than one year or more) are usually **called Government Bonds or Dated Securities.**
- In India, the **Central Government issues both treasury bills and bonds or dated securities** while the **State Governments issue only bonds or dated securities,** which are called the State Development Loans (SDLs).
- G-Secs carry practically no risk of default and, hence, are **called risk-free gilt-edged instruments.**

    Gilt-edged securities are high-grade investment bonds offered by governments and large corporations as a means of borrowing funds.

- Recently, the **Reserve Bank of India has proposed to allow retail investors to open gilt accounts with the central bank to invest in Government securities (G-secs) directly** and without the help of intermediaries.

Source: TH