



## Mains Practice Question

**Q.** What is Operation Twist? Discuss its impact on the banking sector in India. (150 words)

08 Jul, 2020 GS Paper 3 Economy

### Approach

- In the introduction briefly discuss the operation twist and its history.
- Discuss why there was a need to conduct operation twist in India.
- Mention the impacts of operation twist on the banking sector in India.
- Conclude by summarizing your answer.

### Introduction

- Operation twist is a programme adopted by the central bank (RBI in India) for quantitative easing. In this programme the proceeds from the sale of short term securities is used to buy long term government debt papers leading to earning of interest rates on the long term papers.
- The Reserve Bank of India announced to carry out US-style 'Operation Twist' to boost the economy by bringing down long-term interest rates for the first time under Open Market Operations (OMOs).
- Operation Twist was first used in 1961 by the US Federal Reserve (central bank) as a way to strengthen the U.S. dollar and stimulate cash flow into the economy.

### Body

#### Impact of Operation Twist

- **Prices of bonds:** As the central bank buys long-term securities (bonds), their demand rises which in turn **pushes up their prices.**
  - The bond yield comes down with an increase in prices (inverse relationship). If the yield is low, interest rates decrease.
- **Bank operations:** Due to CRR and SLR norms, banks are bound to keep some amount as Government securities.
  - Operation twist would enable the selling of their long-term bonds to the government since they would lose on yield if they held it for more time.
- **Consumer demands:** If the money meant for the long term would be available to the banks, they would lend it for economic activities such as buying houses, cars or financing projects at lower rates.
- **Escaping stagflation:** Greater borrowing to consumers by the bank could increase the overall demand in the economy.
  - This impetus to the market could rescue the Indian economy from slipping into stagflation due to the lagging economy in Covid-19 crisis.

### Conclusion

Thus, Operation twist could help banks free up their long-term capital for boosting long-term investments and increasing their lending opportunities. It has been an optimistic and prompt remedy in the endeavour to restore the health of Indian economy.

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