Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about Operation Twist and its significance; G-secs: types; Open market operations and their significance

News: On Thursday, the RBI said it would be buying the 6.45% yielding notes maturing in 2029 — the benchmark bonds — and would be selling four papers maturing in 2020. The OMOs would be conducted on Monday.

What exactly is it?

- The Reserve Bank of India (RBI) has commenced something that is akin to the famous “Operation Twist” conducted by the US Federal Reserve by deciding to buy the long-tenor 10-year benchmark bonds worth Rs. 10,000 crore and selling four short-dated securities worth the same amount under open market operations (OMOs).

- The step is liquidity neutral — meaning the OMOs would not be adding any further liquidity to the system that is already flush with excess liquidity to the tune of over Rs. 2 lakh crore.

- The simultaneous purchase and sale of securities would also help in flattening the steep yield curve — where long tenor yields have been high and short-term yields have been low.

- For instance: despite a 60 bps reduction in the repo rate across two monetary policies in August and October, the benchmark yield remains higher by 38 basis points since August. At the same time, the system liquidity has been so high that short-tenor yields have remained fairly low. In some instances, even the 364-day treasury bill yield has gone below the repo rate — a not so usual occurrence.

Way ahead

- Experts believe that the central bank may do more of these OMO purchases/sales in coming times that will eventually bring down excess supply of long-tenor bonds in the market.
Transmission has been a big issue in this rate cut cycle. The long tenor G-sec yields have not moved lower since last couple of rate cuts. This will bring down the term premium and will be one more step towards improving transmission of rates. This will also help to absorb excess long tenor bond supply that could be hitting the market on account of potential fiscal slippage from budgeted levels.

Open Market Operations (OMO)

- Open market operations is the sale and purchase of government securities and treasury bills by RBI or the central bank of the country.
- 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.
- Features: When the RBI wants to increase the money supply in the economy, it purchases the government securities from the market and it sells government securities to suck out liquidity from the system.

About G-Secs

- A government security (G-Sec) is a debt obligation of the Indian government to fund their fiscal deficit. These instruments are tradable and are issued either by the central or the state government. These securities are offered for short term as well as long term. Short-term instruments with a maturity of less than one year are typically called treasury bills (T-Bills) whereas long-term instruments are called government bonds or dated securities with a maturity of one year or more.

- However in India, the central government issues T-Bills as well as bonds or dated securities while the state government issues only the bonds or dated securities called State Development Loans (SDL). The central government also issues not fully tradable savings instruments like savings bonds, national saving certificate etc or special securities like oil bonds, fertilizer bonds, power bonds etc.

Types of G-Sec

1. Treasury Bills (T-bills): T-bills are money market short term debt instruments which are issued by the central government in three tenures mainly 91-day,
182-day and 364-day. These instruments are zero coupon bonds which pay no interest but are actually issued at a discount and redeemed at the face value at maturity.

2. **Cash Management Bills (CMBs):** CMBs are a new short-term instrument having common characteristic of T-Bills but with a maturity of less than 91-days. These instruments are issued to meet the temporary disparity in the cash flow of the government. CMBs too are issued at a discount and redeemed at face value on maturity.

3. **Dated Government Securities:** These instruments are long-term securities which carry a fixed or floating coupon (interest) rate paid on the face value, which is payable at fixed time periods generally half-yearly. The maximum tenure of these securities is 30 years.