

Operation Twist

Why in News?

The Reserve Bank of India decided to conduct its version of 'Operation Twist' through simultaneous purchase and sale of government securities under Open Market Operations (OMOs) for Rs 10,000 crore each.

What is Operation Twist?

- Operation Twist is the name given to a US Federal Reserve monetary policy operation.
- It involves the **purchase and sale of government securities** to boost the economy by bringing down long-term interest rates.
- It normally leads to lower longer-term yields, which will help boost the economy by making loans less expensive for those looking to buy homes, cars and finance projects.
- But saving becomes less desirable because it doesn't pay as much interest.

What is the US experience?

- In 1961, the John F Kennedy administration proposed a solution to revive the weak economy through lower longer-term interest rates while keeping short-term interest rates unchanged.
- This initiative is now known as 'Operation Twist' which was employed by the US Fed.
- The Fed then implemented it again in late 2011 and 2012 to stimulate the economy hit by the global financial crisis.
- In December 2012, the Fed ended the programme and replaced it with another policy of "quantitative easing".
- This policy seeks to lower long-term rates by making open-market purchases of longer-dated Treasuries and mortgage-backed securities.

Why Operation Twist now?

- The RBI slashed repo rate by 135 points to 5.15% this year but banks passed on only part of it.
- The one-year median Marginal Cost of funds based Lending Rate (MCLR) has declined only 49 basis points (bps).
- The RBI says the decision follows a review of the current liquidity and

market situation and an assessment of the evolving financial conditions.

- It is keen that long-term rates are brought down to kick start investment and revive the economy.
- The idea is that business investment and housing demand were primarily determined by longer-term interest rates.

What the RBI plans on December 23, 2019?

- The central bank has decided to purchase Rs 10,000 crore worth of one security - the 6.45% GS 2029. This is a long term 10-year bond.
- When the RBI purchases 6.45% bond on December 23, demand is expected to rise, leading to lower long-term yield.
- On the sell side, it has proposed to sell four short term securities which will mature in 2020 for a total of Rs 10,000 crore - 6.65% GS 2020, 7.80% GS 2020, 8.27% GS 2020 and 8.12% GS 2020.
- The sale of short-term securities will push up the short-term rate.
- However, bankers say 'Operation Twist' is likely to put an end to the interest rate cut expectations.

What are Open Market Operations?

- Open market Operations (OMOs) are the market operations conducted by the RBI by way of sale and purchase of G-Secs to and from the market.
- OMOs are done with an objective to adjust the rupee liquidity conditions in the market on a durable basis.
- With this monetary tool the RBI manages and controls the liquidity, rupee strength and monetary management through purchase and sale of government securities (G-Secs).
- When the RBI feels that there is excess liquidity in the market, it resorts to sale of securities thereby sucking out the rupee liquidity.
- Similarly, when the liquidity conditions are tight, the RBI may buy securities from the market, thereby releasing liquidity into the market.
- On Friday, the yield on 10-year benchmark bonds fell by 13 bps to 6.60%, following the RBI announcement.

Source: Indian Express