



CURRENT AFFAIRS



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OPEN MARKET OPERATIONS (OMO)

This article covers "Daily Current Affairs" and the topic details "Open Market Operations (OMO)". This topic has relevance in the Economy section of the UPSC CSE exam.

For Prelims:

About Open Market Operations (OMO)?

For Mains:

*GS 3: Economy
Importance of OMO?*

Why in the news?

The bond market was caught off guard by the Reserve Bank of India's recent statement regarding its contemplation of conducting an Open Market Operation (OMO) sale of government securities to address liquidity concerns. This surprise stemmed from the fact that the central bank did not provide any precise schedule for the proposed action.

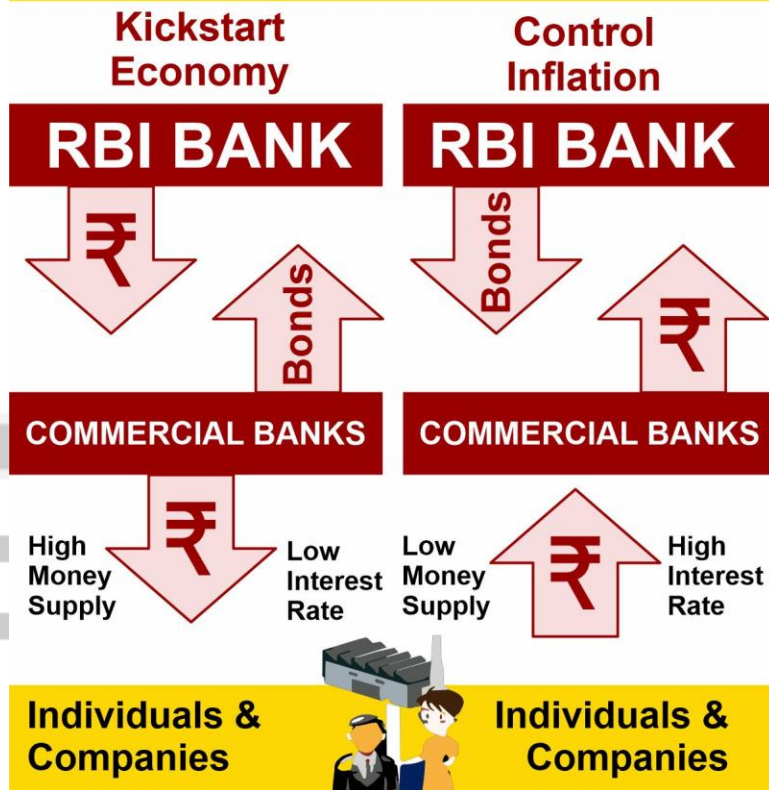
About Open Market Operations (OMO)

Open Market Operations (OMO) are a pivotal tool employed by the Reserve Bank of India (RBI) for the purpose of regulating money supply and liquidity conditions within the financial system. This monetary policy mechanism revolves around the buying and selling of government securities (G-secs) in the open market.

Purpose of OMO:

- OMO serves as a strategic instrument to fine-tune money supply dynamics and influence interest rates.
- To reduce excess liquidity, the RBI engages in the sale of G-secs, while purchases of G-secs inject liquidity into the financial system.
- Regular OMO activities are conducted to strike a balance between controlling inflation and ensuring that banks maintain sufficient funds for lending.

Open Market Operations



Monetary Policy Tools:

- In conjunction with OMO, the RBI utilizes an array of other monetary policy tools such as the repo rate, cash reserve ratio (CRR), and statutory liquidity ratio (SLR) to regulate both the volume and cost of money circulating in the economy.

RBI's Discretion in OMO:

- The RBI retains authority over several aspects of OMO transactions:
 - It determines the quantum of individual securities to be bought or sold.
 - Bids/offers for less than the aggregate amount are considered.
 - The RBI may marginally adjust the purchase/sale amounts due to rounding-off.
 - The central bank has the discretion to accept or reject bids/offers, either wholly or partially, without the obligation to provide specific reasons.

Impact on Money Supply:

- The mechanism underlying OMO transactions is such that when the RBI purchases government bonds, it disburses funds, thereby increasing the total reserves within the economy, resulting in the expansion of the money supply.
- Conversely, when the RBI sells government bonds, it diminishes reserves, leading to a contraction in the money supply.

Government Securities (G-secs):

- G-secs represent tradable financial instruments issued by the central and state governments as evidence of their debt obligations.

- They encompass short-term instruments known as Treasury Bills and long-term securities referred to as Government Bonds or Dated Securities.
- G-secs are widely regarded as risk-free, making them attractive investments.

Importance of OMO:

- In India, liquidity conditions typically tighten during the latter half of the financial year, commencing from mid-October.
- Factors contributing to this tightening include reduced government expenditure, heightened currency demand during the festive season, and fluctuations in foreign institutional investments and tax payments.
- OMO plays a crucial role in ensuring consistent liquidity availability throughout the year, thus maintaining desired interest rate levels.
- By conducting OMO operations, the RBI aims to avert cash shortages for both banks and borrowers, contributing to overall financial stability.

SOURCE:

[Why RBI's Open Market Operation plan caught the market by surprise \(indianexpress.com\)](https://www.indianexpress.com)

Q.1 Consider the following statements regarding Open Market Operations (OMO) in India:

1. OMO is primarily aimed at controlling inflation in the economy.
2. When the RBI purchases government bonds through OMO, it contracts the money supply within the economy.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

ANSWER: A

Q.2 Government Securities (G-secs) in India include:

- (a) Only Treasury Bills
- (b) Only Government Bonds
- (c) Both Treasury Bills and Government Bonds
- (d) Neither Treasury Bills nor Government Bonds

ANSWER: C

Q.3 Discuss the role of the Reserve Bank of India (RBI) in using Open Market Operations (OMO) as a monetary policy tool. Provide examples and insights into the significance of OMO in the context of India's economic and financial landscape.

Rishabh