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# The relevance of the OMO device in the arsenal of RBI – Mint

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Open market operations, or OMOs, consist of the purchase and sale of G-Sec by the Reserve Bank of India (RBI) on behalf of the Center in order to rationalize money supply and interest rates. If there is excess liquidity in the market, RBI issues these securities through auctions, Mint explains.

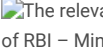
### What is the impact of OMOs on the money supply?

They are one of the three main monetary tools (besides the reserve ratio and policy rates) for influencing the money supply in the market and achieving the desired trend in interest rates. There is an inverse relationship between bond prices and interest rates. Thus, buying bonds through an OMO raises the price of bonds and reduces rates. Purchases in the free market increase the money supply, making money less valuable, leading to lower rates in the money market, and vice versa. Monetary tools such as repo rate, reverse repo, marginal standing facility rate, and bank rate are policy rates, while CRR and SLR are reserve ratios.

### What are the main objectives of OMOs?


OMO's aim to control the money supply or existing liquidity in the economy. In the event of an inflationary situation, the RBI adopts a contractionary monetary policy, that is, it sells


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credit availability for investment and production. So he buys securities, increasing the money supply. RBI conducts OMOs through commercial banks and eligible participants are required to enter their offers on RBI's core electronic banking solutions platform, E-Kuber.

[View full picture](#)

Executive liquidity

### How do government securities work?

These are debt securities issued by the RBI, on behalf of the government, to borrow money. These can be treasury bills that are money market, short-term debt securities, or dated securities that are long-term instruments. Government securities are a promissory note with guaranteed payment at a zero coupon rate and issued at a reduced rate.

### What is the function of the bond market?

Bond prices and interest rates have a negative relationship as the money supply and treasury bills move in different directions. When the RBI hints at a position of excess liquidity, short-term rates tend to fall and money market prices rise, while, when the RBI signals a tightening of liquidity in the system, short rates tend to fall. futures soar and the prices of money market instruments fall. With RBI rates falling, long-term stuck investors with higher yields stand to gain. In bond markets, rate expectations matter more than actual announcements.

### How did the bond market react after the budget?

Banks, the biggest buyers of government bonds, prefer a falling interest rate. The budget deficit figures and the Centre's borrowing plan announced on February 1 led to a surge in 10-year bond yields to 6.071%, which fell to 6.031% on February 8. RBI maintained an accommodating stance on liquidity. On February 8, he announced his intention to buy bonds worth ₹20,000 crore via OMO, supporting the Centre's borrowing program.

*Jagdish Shettigar and Pooja Misra are faculty members of BIMTECH*

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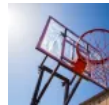
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