Operation Twist

Operation Twist is an open market operation conducted by a nation's central bank where Short-term securities are sold and long-term securities bought, simultaneously.

The term was first used in 1961 when the Federal Open Market Committee of the United States conducted a similar move. The Reserve Bank of India also carried out a similar operation in April 2020.

Origins of Operation Twist

The Federal Open Market Committee first initiated Operation Twist in 1961 in order to flatten the yield curve so that capital inflows could be promoted and the strength of the dollar improved. The operation was named after the 'twist' dance craze of the time.

Open market operations were utilized to shorten the maturity period of public debt. By selling some of the short term debt, it used the money received to buy longer term government debt. The operation was marginally successful in reducing the spread between long-term and short-term maturities. Although considered a failure in 1961, economists in 2011 did reexamine and eventually asserted that Operation Twist was effective than originally thought

Operation Twist in the Indian context

The Reserve Bank of India (RBI) undertook an operation for a simultaneous purchase and sale of government securities under Open Market Operations. The amount was for 10,000 crores based on the prevailing current and evolving liquidity market conditions in April 2020.

A similar operation was first conducted in December 2019.

Similar to the American Operation Twist, the RBI operation was carried out by selling of short-term securities and buying of long term securities through Open Market Operations in order to bring down long term interest rates.

Why was Operation Twist carried out in India?

Despite RBI slashing the repo rate by 135 points to 5.15 but only a few portions of it were passed on by the banks. The single-year median marginal cost of funds based lending rate has declined only 49 basis points.

The result of Operation Twist leads to lower longer-term yields, that plays a crucial role in boosting the economy. It is that business investment and housing demand were primarily determined by longer-term interest rates.

The impact of Operation Twist can be summarized as follows:

- Demand rises through a central bank buying bonds which in turn pushes up their prices.
- The interest rate in an economy is determined through yield. In the event that the yield is low, the interest rate decreases.
- If long-term interest rates are lowered, then it will be possible for the common folk to obtain long-term loans at reasonable rates.
- With this boost in consumption and spending in the economy which will lead to its revival.