Open market operations: The central bank's new communication policy

MANOJIT SAHA & ANJALI KUMARI
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Ever since he took charge as governor of the Reserve Bank of India (RBI) in December last year, Sanjay Malhotra has shown he is not a prisoner of past practices of the central bank.

From prioritising growth over inflation with cutting policy rates and changing its stance to "accommodative", an aggressive intervention strategy in foreign exchange, pushing back deadlines for making operational the liquidity coverage ratio while relaxing the norms, Malhotra has signalled taking fresh guard in navigating the complex function of running a central bank.

NEWS ANALYSIS

The approach to managing liquidity and communication policy is yet another manifestation of how the central bank has taken a fresh view on the issue. In the first two months (April and May) this financial year alone, the central bank has said it will conduct open market operations (OMOs) of ₹2.25 trillion to infuse liquidity by buying bonds. Last financial year, ₹2.5 trillion was pumped in — between January and March. "The aggressive pace of OMO purchases is likely to eclipse even the pandemic period," said Gaura Sen Gupta, chief economist, IDFC First Bank.

The change in communication policy to conduct OMOs in recent times is interesting. Except in the Covid-19 period, rarely has the central bank announced an OMO calendar or a schedule for OMO auctions. In a departure from past practice, the RBI has given a timeline, stating on which date how much will be pumped in.

Central-bank watchers say in the past the RBI believed it was not possible to forecast liquidity situations one month, or even a fortnight, in advance. As a result, a schedule for OMO auctions was not announced. Also, since OMOs are meant to provide durable liquidity, such auctions are for sterilisation, that is, balancing liquidity due to intervention in the foreign-exchange market. And it was not possible to predict when to intervene in the foreign-exchange market.

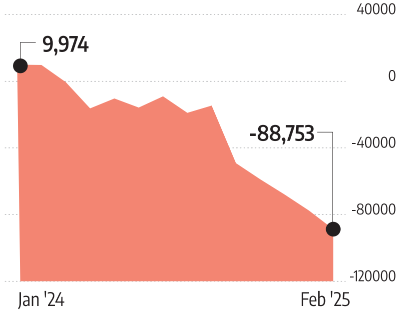
OMO auctions (₹ crore)

FY25		FY26	
Jan 30	20,000	Apr 8	20,000
Feb 13	40,000	Apr 17	40,000
Feb 20	40,000	Apr 22	20,000
Mar 12	50,000	Apr 29	20,000
Mar 18	50,000	May 6	50,000
Mar 25	50,000	May 9	25,000
		May 15	25,000
		May 19	25,000

Source: RBI

Buildup of short positions

Net outstanding forward position (in $ million)
Source: RBI



Announcing an OMO calendar would mean that the central bank has assessed the liquidity conditions for the next one month and decided on the amount to be infused. "In case the liquidity situation does not turn out as projected, which results in cancelling or trimming the size of the OMO, there is a credibility issue," said a market participant.

In February, the RBI increased the size of some OMOs as compared to what had been announced. It indicates the RBI took a view on the minimum level of liquidity required to be maintained and, if needed, the size could be increased. In February, the RBI increased the amount of its two OMO purchase auctions from ₹20,000 crore to ₹40,000 crore each as the net liquidity deficit in the banking system was above ₹2 trillion. The other interesting aspect of the current OMO spree is that, in the past, such auctions to infuse liquidity were driven by spikes in overnight rates. This time around the trigger was not rates but tight liquidity. The first OMO was announced on January 27 after the liquidity deficit went up beyond ₹3 trillion while overnight rates were stable.

The weighted average call rate was trading around 6.85 per cent when the RBI announced the first series of OMO auctions, slightly changed from 6.77 per cent at the start of the calendar year. "The RBI is now targeting the extent of liquidity to ensure that the transmission of rate cuts takes place. This is a departure from the earlier practice of targeting the overnight rate only," Sen Gupta said. And the April OMO calendar was announced even after liquidity was in surplus. There were at least two considerations in this. First, it is to accelerate monetary transmission. The RBI's experience shows transmission in rate revisions to lending and deposit rates of banks takes two quarters. The RBI wants to reduce it. "While the first set of liquidity responses was to correct an overly tight situation, the current one may be aimed at ensuring a broadbased transmission of rate cuts," said Suyash Choudhary, head (fixed income), Bandhan Mutual Fund.

SBI's group chief economic adviser, Soumya Kanti Ghosh, said: "As system liquidity has remained in surplus since end-March, the latest round of OMOs has caught the broader markets somewhat off guard. However, the move looks aligned to keep liquidity in surplus to the level of more than ₹2 trillion."

The second reason for liquidity infusion is the significant buildup of short positions in the forward books of the RBI. They were around $88.75 billion as of the end of February. The March data showed the central bank had started to cut down the forward books. To enable effective transmission in rate cuts, the RBI is expected to maintain system liquidity in the range of 1 per cent to 1.2 per cent of net demand and time liabilities, necessitating a further infusion of durable liquidity.