



Currency Swap Facility

Why in News

Recently, **Bangladesh cleared a USD 200 million currency swap facility for Sri Lanka**, to help boost its economy.

Key Points

▪ About:

- The **word swap** means **exchange**. A **currency swap** between the two countries is an **agreement or contract to exchange currencies** with predetermined terms and conditions.
- In the **present context**, a currency swap is effectively **a loan that Bangladesh will give to Sri Lanka in dollars**, with an agreement that the **debt will be repaid with interest in Sri Lankan rupees**.
- **Central banks and Governments** engage in currency swaps **with foreign counterparts** to meet **short term foreign exchange liquidity** requirements or to ensure adequate foreign currency to **avoid Balance of Payments (BOP) crisis** till longer arrangements can be made.
 - **For Sri Lanka**, this is **cheaper than borrowing from the market**, and a lifeline as it struggles to maintain adequate forex reserves even as repayment of its external debts looms.
- These swap operations carry **no exchange rate or other market risks** as transaction terms are set in advance.
 - **Exchange rate risk**, also known as **currency risk**, is the financial risk arising from **fluctuations in the value of a base currency against a foreign currency** in which a company or individual has assets or obligations.

▪ Unusual for Bangladesh:

- Bangladesh has **not been viewed so far as a provider of financial assistance to other countries**. It has been **among the most impoverished countries of the world**, and **still receives billions of dollars in financial aid**.
- But **over the last two decades**, it has **managed to elevate its economy itself majorly**, and in **2020**, was the **fastest growing in South Asia**.
 - The country has **managed to pull millions out of poverty**. Its **per capita income just overtook India's**.
- This **may be the first time that Bangladesh is extending a helping hand** to another country, so this is a landmark of sorts.

▪ Sri Lanka's Approach to India:

- In 2020, the President of Sri Lanka **requested India for a USD 1 billion credit swap**, and separately, **a moratorium** on debts that the country has to repay to India.
- But India-Sri Lanka relations have been **tense over Colombo's decision to cancel a**

valued container terminal project at [Colombo Port](#), which made India put off the decision.

- **Earlier, in July 2020, the Reserve Bank of India (RBI) extended a USD 400 million credit swap facility to Sri Lanka**, which the Central Bank of Sri Lanka settled in February. The arrangement was not extended.
- **RBI's Framework for Swap Facilities for SAARC:**
 - The [SAARC currency swap facility](#) came into operation on **15th November, 2012**.
 - The **revised framework** is valid from 14th November, 2019 to 13th November, 2022.
 - The **RBI can offer a swap arrangement within the overall corpus of USD 2 billion**.
 - The swap draws can be made in US dollar, euro or Indian rupee. The framework provides **certain concessions for swap draws in Indian rupee**.
 - The facility will be **available to all SAARC member countries**, subject to their signing the bilateral swap agreements.
 - The **presumption was that only India, as the regional group's largest economy, could do this**. The **Bangladesh-Sri Lanka arrangement shows that is no longer valid**.

Balance of Payment

▪ Definition:

- **Balance of Payment (BoP)** of a country can be defined as a **systematic statement of all economic transactions of a country with the rest of the world** during a specific period usually one year.
- Overall the **BoP account can be a surplus or a deficit**.
 - If there is a deficit then it can be bridged by taking money from the **Foreign Exchange (Forex) Account**.
 - If the reserves in the forex account are falling short then this scenario is referred to as **BoP crisis**.

▪ Components of BOP:

- **Current Account:** It shows **export and import of visibles and invisibles** (includes goods and services).
- **Capital Account:** It shows a capital expenditure and income for a country. It gives a **summary of the net flow of both private and public investment** into an economy.
- **Errors and Omissions:** Sometimes the balance of payment does not balance. This imbalance is shown in the BoP as errors and omissions.

Foreign Exchange Reserves

- **Foreign exchange reserves** are **assets denominated in a foreign currency that are held by a central bank**.
- These may include **foreign currencies, bonds, treasury bills, and other government securities**.
- These reserves are used **to back liabilities and influence monetary policy**.

[Source: TH](#)

