Talks for Dollar Swap Agreement

Why in News

India is working with the United States to secure a dollar (currency) swap line that would help in providing an additional comfort in an event of any abrupt outflow of funds.

- India **already has a currency swap facility with other central banks** like Japan, UAE etc.

Key Points

- As concerns on the economic effects of COVID-19 hit investor sentiment, Foreign institutional investors (FIIs) have been **large sellers of Indian equity and debt markets** in March and April so far. This has led to outflow of funds from the country.
- To stabilise the rupee which recently fell below the 76 level against the dollar, India liquidated (converted into cash) its forex assets.
  - **Forex reserves/assets** (also called foreign exchange assets) are **assets held on reserve by a central bank in foreign currencies.** These may **include foreign currencies,** bonds, treasury bills and other government securities. These are held **to ensure that a central bank has enough funds if its national currency weakens/ devalues rapidly.**
- India's foreign currency assets had declined by around $7.50 billion in two weeks to $ 439.66 billion as on March 27.
  - According to Reserve Bank of India (RBI) data, 63.7 per cent of India's foreign currency assets — or $256.17 billion — is invested in overseas securities, mainly in the US treasury.
- While India is expected to comfortably tide over any challenge posed by continued outflows of funds from the markets, given the adequacy of foreign exchange reserves, a swap line with the US Fed provides an additional comfort to the forex markets.

Dollar Swap

- Dollar swap is a kind of currency swap. The word swap means exchange.
- A currency swap between the two countries is an **agreement to exchange currencies with predetermined terms and conditions.**
- In a dollar swap arrangement, the US Federal Reserve will provide dollars to a foreign central bank. At the same time, the foreign central bank provides the equivalent amount of funds in its currency to the Fed, based on the market exchange rate at the time of the transaction.
- The parties agree to swap back these quantities of their two currencies at a specified date in the future, which is the next day or as far ahead as three months, using the same exchange rate as in the first transaction.
- These swap operations carry no exchange rate or other market risks as transaction terms are set in advance.
- **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.

Source: IE