# Currency Swap Facility

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## 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 drawals can be made in US dollar, euro or Indian rupee. The framework provides **certain concessions for swap drawals 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**