

Currency swap between Bangladesh and Sri Lanka

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In news- Bangladesh's central bank recently approved a \$200 million currency swap facility to Sri Lanka.

More about the arrangement-

- Bangladesh Bank, the country's central bank, has in principle approved a \$200 million currency swap agreement with Sri Lanka to help Colombo tide over its foreign exchange crisis.
- Sri Lanka, staring at an external debt repayment schedule of \$4.05 million in 2021 is in urgent need of foreign exchange.
- Its own foreign exchange reserves in March year stood at \$4 million.
- The two sides have to formalise an agreement to operationalise the facility approved by Bangladesh Bank.
- 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.
- 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.
- The period of the currency swap will be specified in the agreement.
- This may be the first time that Bangladesh is extending a helping hand to another country.
- It is also the **first time that Sri Lanka is borrowing from a SAARC country other than India.**
- In July 2020, the Reserve Bank of India had extended a

\$400 million credit swap facility to Sri Lanka, which the Central Bank of Sri Lanka settled in February, 2021.

What is a currency swap?

- A currency swap between two countries is an agreement or contract to exchange currencies (of the two countries or any hard currency) with predetermined terms and conditions.
- Often the popular form of currency swap is between two central banks.
- Here, the **main purpose of currency swap** by a central bank like the RBI is to get the foreign currency from the issuing foreign central bank at the predetermined conditions (like exchange rate and the volume of currency) for the swap.
- The purpose of currency swap is to avoid turbulence and other risks in the foreign exchange market and exchange rate.
- Currency swap agreement **can be bilateral or multilateral.**
- RBI has a framework under which it can offer credit swap facilities to SAARC countries within an overall corpus of \$2 billion.
- The SAARC currency swap facility came into operation in November 2012.
- Usually, currency swap agreements are of **five types** depending upon the nature and the status of the currencies swapped –
 - Exchange cash for cash vs cash for securities;
 - Exchange conditional vs unconditional swaps;
 - Exchange reserve currencies on both sides;
 - Exchange reserve currency for non-reserve currency;
 - Exchange non-reserve currencies on both sides.