

What does dollar-rupee swap mean?

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In news- The Reserve Bank of India (RBI) has conducted a \$ 5 billion dollar-rupee swap auction as part of its liquidity management initiative recently.

What is the Dollar-Rupee swapping system?

- **Currency swap** is a **forex tool** whereby the **central bank uses its currency to buy another currency** or vice versa.
- In a Dollar–Rupee buy/sell swap, the **central bank buys dollars (US dollars or USD) from banks in exchange for Indian Rupees (INR)** and immediately gets into an opposite deal with banks promising to sell dollars at a later date.
- It is the RBI's useful policy toolkit as it offers the central bank a chance to directly influence both the value of the rupee and the amount of liquidity in the economy at the same time using a single tool.
- The swap auction can be done in the reverse way also when there is shortage of liquidity in the system, where RBI then buys dollars from the market and releases an equivalent amount in the rupees.

Its impact-

- The central bank's move will **reduce the pressure on inflation and strengthen the rupee.**
- It leads to **infusion of dollars and sucking out of the rupee** from the financial system, thus reducing the rupee liquidity in the system.
- The RBI normally brings down liquidity in the system when inflation threatens to rise sharply.

- **After the recent swap auction, the rupee recovered to 76.92 from 76.97.**

Variable Rate Reverse Repo auction (VRRR)-

- VRRR is a sub-type of reverse repo, which is undertaken to reduce the money flow by taking out existing cash present in the system.
- In order to reduce Surplus liquidity in the system, usually, the central bank will resort to traditional tools such as increasing the repo rate or increasing the cash reserve ratio (CRR), but this can have a negative implication on the economy.
- Therefore, the RBI used a different toolkit- VRRR in 2021.
- However, the recent VRRR auctions were undersubscribed by banks, as the cash market offered instant and better yields, forcing the RBI to consider a longer-term liquidity adjustment tool such as forex auctions.