Indo-Japan Currency Swap Arrangement

Why in news?

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Union government recently signed a bilateral currency swap arrangement with Japan.

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What is the currency swap arrangement all about?

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- A bilateral currency swap is an open-ended credit line from one country to another at a fixed exchange rate.
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- The country which avails itself of this loan pays interest to the country which provides it, at a benchmark interest rate such as the Libor (London Inter-bank rate).
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- While India has such arrangements with many Asian nations, the arrangement with japan is among the largest of such deals, valued at $75 billion.
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- The government hopes that this deal will act as a buffer to shore up the rupee, which has depreciated by 14 per cent against the dollar this year.
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How the arrangement will work?

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- The currency swap arrangement will allow the Indian central bank to draw up to $75 billion worth of yen or dollars as a loan from the Japanese government whenever it needs this money.
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- The RBI can either sell these dollars (or yen) to importers to settle their bills

or to borrowers to pay off their foreign loans.
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- The RBI can even hang on to the money to shore up its own foreign exchange reserves and defend in the rupee.
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- While the RBI had amassed foreign currency reserves of over $426 billion by April 2018, it has had to use up some of this in recent weeks to prop up the rupee.
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- Though present forex reserves at over $390 billion are still comfortable, having a $75-billion loan-on-demand from Japan gives the RBI an additional buffer to fall back on, should it need extra dollars.
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What is the reason behind such arrangement?

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- In recent times, the rupee has been falling against the dollar because of its widening current account deficit (the difference between imports and exports of goods and services).
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- This leads to importers upping their demand for dollars far beyond what exporters bring into the country.
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- A swap arrangement with Japan provides considerable comfort to India, because Japan is the second largest holder of dollar reserves in the world after China and is sitting on fat coffers of over $1,250 billion.
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- Therefore, while Japan is quite unlikely to ask India for a dollar loan, India can make use of such a loan at rock-bottom interest rates.
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- Japan may also see this deal as quid pro quo for lucrative investment deals that help Japanese companies set up shop in India.
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Source: Business Line

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