Currency swap agreement between India and Japan

30th Oct, 2018

What to study?

For Prelims and Mains: Meaning, significance and implications of Currency swap.

Context: Japan and India have entered into a $75-billion currency swap arrangement that will bolster the country's firepower as it battles a steep drop in the rupee's value. An agreement to this effect was signed during Prime Minister Narendra Modi's ongoing visit to Japan.

Key facts:

- The Agreement shall aid in bringing greater stability to foreign exchange & capital markets in India. The facility will serve as a second line of defence for the rupee after the $393.5 billion of foreign exchange reserves that the Reserve Bank of India (RBI) has at its disposal.
- Under the arrangement, India can acquire dollars from Japan in exchange for rupees. Conversely, Japan can also seek dollars from India in exchange for yen.
- The arrangement will be used only when required, and will help meet short-term liquidity mismatches.

Significance of the agreement:

- The currency swap agreement is an important measure in improving the confidence in the Indian market and it would not only enable the agreed amount of capital being available to India, but it will also bring down the cost of capital for Indian entities while accessing the foreign capital market.
- The swap arrangement should aid in bringing greater stability to foreign exchange and capital markets in India. With this arrangement in place, prospects of India would further improve in tapping foreign capital for country's developmental needs. This facility will enable the agreed amount of foreign capital being available to India for use as and when the need arises.

What is this Currency Swap Arrangement (CSA)?

This is an arrangement, between two friendly countries, which have regular, substantial or increasing trade, to basically involve in trading in their own local currencies, where both pay for import and export trade, at the pre-determined rates of exchange, without bringing in third country currency like the US Dollar.

In such arrangements no third country currency is involved, thereby eliminating the need to worry about exchange variations.

To be looked in UPSC Paper 2: India and its neighbourhood- relations.