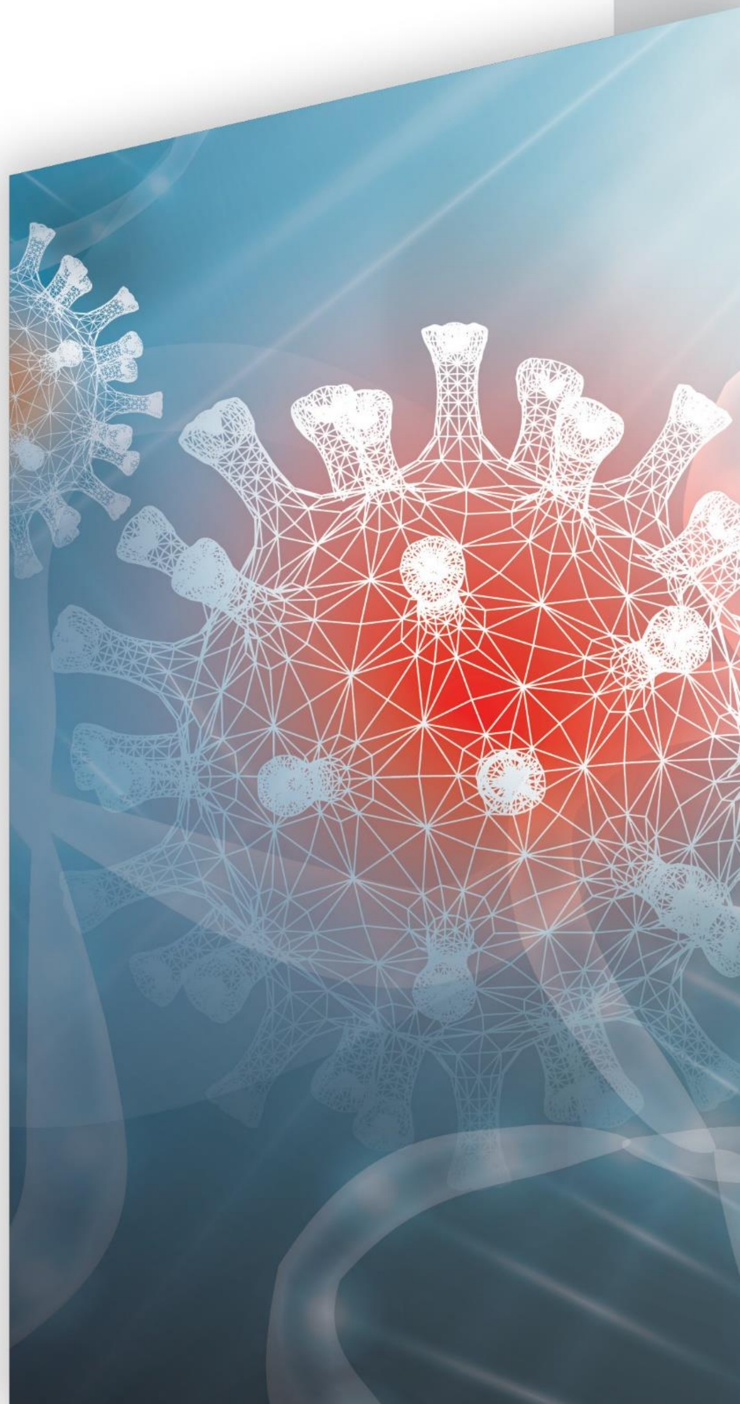
UNITED NATIONS DEVELOPMENT ACCOUNT PROJECT

JULY 2021

COVID-19
Response and Recovery
Mobilizing financial resources for development

DA-COVID-19 project led by Debt and Development Finance Branch, Division on Globalization and Development Strategies (DDFB/DGDS)



JULY 2021

Currency Swap Agreements

Debt and Development Finance Branch
UNCTAD

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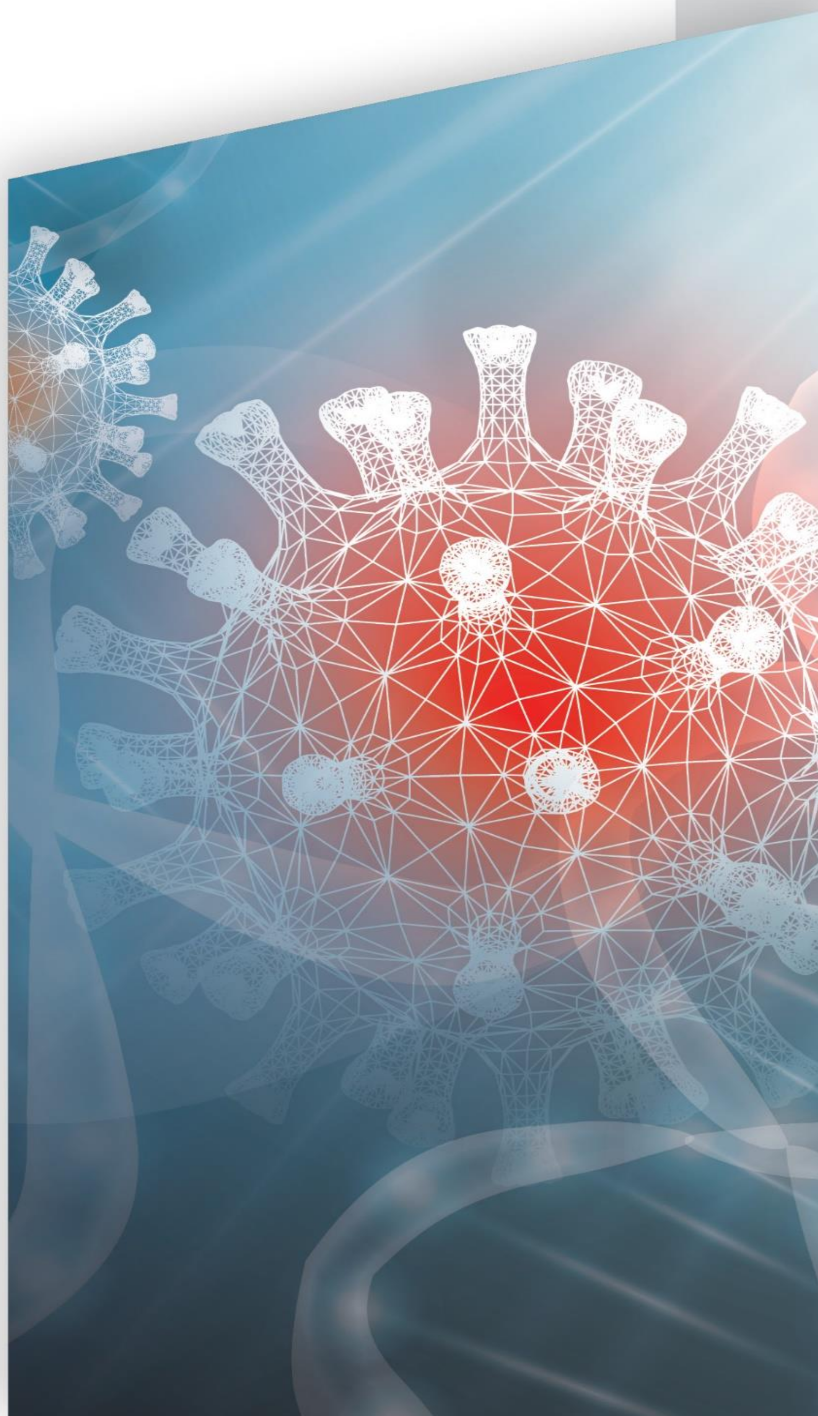

About the COVID-19 Response and Recovery project

This paper is an output from the project "Response and Recovery: Mobilising financial resources for development in the time of COVID-19", which is co-ordinated by the Debt and Development Finance Branch of UNCTAD and jointly implemented with ECA, ECLAC and ESCAP. This project is one of the five UN Development Account short-term projects launched in May 2020 in response to the COVID-19 crisis.

The project aims to enable low-income and middle-income developing countries (LICs and MICs) from Africa, Asia-Pacific, and Latin America and the Caribbean to diagnose their macro-financial, fiscal, external financial and debt fragilities in the global context, and design appropriate and innovative policy responses to the COVID-19 pandemic leading toward recoveries aligned with the achievement of the Sustainable Development Goals (SDGs).

Contents

What are Central Bank currency swap agreements (CSAs)? 5
CSA are flexible arrangements. Specific contracts vary in terms of: 6
CSAs played a key role during the COVID-19 crisis: 6
Further readings: 7

What are Central Bank currency swap agreements (CSAs)?

During the COVID-19 crisis, swaps between central banks played a major role in providing short term liquidity – accounting for almost 95 per cent of the value of transactions provided by the Global Financial Safety Net (GFSN). In the discussion below, we set out a description of these swaps, the role they play and how they came to be so important.

Swaps are credit lines between two central banks in which the borrowing institution receives foreign currency from the creditor institution and provides its own currency as collateral. At maturity, the borrower repays the loan, in addition to the agreed interest rate. Repurchase Agreements (repos) are similar to CSAs, typically for a shorter period, where central banks accept financial assets denominated in hard currency as collateral. Not all swap agreements are the same (the table below summarizes the main variations), but the lack of conditionalities is usually a feature. Swap lending is often seen as a sign of trust between participant monetary authorities, since there are few binding mechanisms between the parties.

Until 1976, the IMF was the only source of short-term external liquidity available for countries. Over time, new forms of liquidity insurance at the global, regional, and bilateral level emerged, leading to the setting-up of the Global Financial Safety Net (GFSN). At its broadest, the GFSN encompasses IMF lending, Multilateral Development Banks, Regional Financial Arrangements, repos, and swaps. The use of swaps dates to 1962, but it was only during the Global Financial Crisis of 2008 that they emerged as a key component of the GFSN. During the COVID-19 crisis, swaps also played a major role: out of the USD 1.8 trillion loaned through the GFSN between February 2020 to March 2021, CSAs accounted for at least USD 1.7 trillion (or 94.4 per cent).

Central banks that have swap agreements with overseas partners can offer foreign currency liquidity to domestic commercial banks when market conditions are worsening, greasing the wheels of international trade and finance and potentially curbing exchange rate volatility.

Swap agreements do not substitute other GFSN components, but swaps' unique features can bring elasticity and responsiveness to the GFSN. While under repo agreements a country's borrowing capacity is limited by its foreign reserve levels, with CSAs the international monetary system's aggregate liquidity is expanded, that is why CSAs are a more appropriate tool to address systemic crises. Comparing with regional and global components of the GFSN, the readiness of resources is a further advantage of swaps. When central banks have valid CSAs, resources can be accessed almost instantaneously. Still, swaps do not need to be withdrawn to play a constructive role. Swaps function as an additional liquidity buffer beyond foreign reserves, with the advantage of being costless to acquire and maintain (when not withdrawn), providing reassurance for central banks and national treasuries alike.

During the COVID-19 pandemic, more than 50 central banks could borrow through swap agreements. Most arrangements were provided by the US Federal Reserve (with 14 partner central banks) and the People's Bank of China (with 34 partner central banks), but in total, the GFSN includes a further 30 lender central banks, with 15 of them being from emerging market and developing economies. Additionally, several central banks signed reciprocal CSAs, in which monetary authorities agreed to mutually assist each other in time of crisis.

More details on the use of swaps during the COVID-19 pandemic, as well as IMF lending and Regional Financial Arrangements, can be found at the GFSN tracker (link).

CSA are flexible arrangements. Specific contracts vary in terms of:

Contract tenure	Short (up to a year)/long (3-10 years)/ Standing agreement (no end date).
Volume	Defined maximum volume/Unlimited.
Currency	Creditor central bank's domestic currency/ Hard currency.
Interest rate	Fixed/ Floating (Usually expressed as a percentage of the inter-bank lending rate of the currency established in the contract)
Reciprocity	Yes/ No

CSAs played a key role during the COVID-19 crisis:

Lending capacity during COVID-19 crisis	Over USD 1.7 trillion
Number of involved monetary authorities	Over 50 borrowers, being 60 per cent of them from low- and middle-income countries. 30 lenders, being half of them from emerging market and developing economies.

Further readings:

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