

Forex Swap: Notes for UPSC Economy

The Reserve Bank of India (RBI) had announced to conduct a forex swap (also referred to as dollar-rupee swap) of \$5 bn. This tool is being used for the first time by RBI, wherein the dollars with banks will be swapped with rupee by RBI.

This article will tell all you need to know about the topic 'Forex Swap'. Economics is an important segment of the IAS exam and is also extensively linked to current affairs.

What is a Forex Swap?

In finance, a foreign exchange swap (forex swap, or FX swap in short) is a simultaneous purchase and sale of identical amounts of one currency for another with two different value dates and may use foreign exchange derivatives. A forex swap allows sums of a certain currency to be used to fund charges designated in another currency without acquiring foreign exchange risk. It permits companies that have funds in different currencies to manage them efficiently.

Structure of a Forex Swap

A foreign exchange swap has two types of transactions - a spot transaction and a forward transaction - that are executed simultaneously for the same quantity, and therefore offset each other. Forward foreign exchange transactions occur if both companies have a currency the other needs. It prevents negative foreign exchange risk for either party. Foreign exchange spot transactions are similar to forward foreign exchange transactions in terms of how they are agreed upon; however, they are planned for a specific date in the very near future, usually within the same week.

Why did RBI conduct a Forex Swap?

The market is always facing tighter liquidity as businesses rush to pay tax in advance as the end of the financial year draws near.

Also the demand for rupees is always expected to spike in the closing weeks of the financial year as a result of a huge spending towards the upcoming general elections that was to start soon after March. So, the timing of the RBI's auction, at the end of the financial year seems to have taken into account these factors.

For the RBI, this helped to boost its forex reserves by another \$5 billion.