

Currency Swap & Line of Credit

Sri Lanka received a \$1 billion loan line from India to help it get over its greatest foreign exchange crisis and buy food, medicine, and other necessities. The State Bank of India and the government of Sri Lanka inked an agreement to this effect.

A credit line of \$1 billion has been arranged for the supply of vital commodities. So far, India has provided Sri Lanka with \$1.4 billion in support in 2022, including a \$400 million RBI currency exchange, the delay of a \$0.5 billion loan, and another half a billion in a line of credit to help the country meet its vital fuel import needs.



What is a Currency Swap Agreement?

- This agreement is made between two countries to exchange the currency of one country for the currency of another country.
- Its purpose is to maintain stability in the foreign exchange market and exchange rate and to avoid other risks.
- A currency swap facility helps a country obtain foreign currency loans at better interest rates than borrowing directly from the market, with payments made at the exchange rate fixed at the time of the agreement.
- It eliminates the risk due to fluctuating exchange rates.

Line of Credit

- Under the Indian Development and Economic Assistance Scheme, the Government of India has supported Lines of Credit (LOCs) to nations in Asia (except Bangladesh, Nepal, and Bhutan), Africa, the Commonwealth of Independent States, and Latin America (IDEAS).
- The Indian Development Assistance Scheme (IDEAS) provides project funding at a reduced rate and contributes to the development of infrastructure and capacity in developing countries.



- The Indian government provides development aid in the form of concessional lines of credit (LOCs) through the Exim Bank of India under the Indian Development and Economic Assistance Scheme (IDEAS).
- The parties agree to swap back these amounts of their respective currencies at a future date, which could be the following day or even two years from now, at the same exchange rate as in the first transaction. It's been more than two years in Sri Lanka's case.
- Within a total corpus of \$2 billion, the RBI also offers comparable swap lines to central banks in the SAARC area. The RBI will continue to offer a swap option within the overall \$2 billion corpus under the framework for 2019-22. Funds can be withdrawn in US dollars, euros, or Indian rupees from other nations.
- To offer a backstop line of funding for short-term foreign exchange liquidity needs or balance-of-payments issues until longer-term funding arrangements could be completed.
- India and Japan already have a \$75 billion bilateral currency swap line, with Japan having the second-largest dollar reserves behind China.

Sri Lanka economic crisis

- Due to the COVID 19 pandemic, the tourism industry in Sri Lanka has suffered significantly, representing more than 10% of GDP and exhibiting huge foreign exchange imports. Many people, especially daily wage earners, and low-income households, are complaining of being unable to buy food grains during the lockdown announced following a surge in COVID infection cases. In many cases, the situation has gone to the extent that essential commodities like milk, sugar and rice have become out of reach of the common people.
- Sri Lanka is dependent on imports to supply its needs, essential commodities, such as petroleum, sugar, dairy products, wheat, medicine, etc., while on the other hand the country's foreign exchange reserves are depleting rapidly. In addition, the Sri Lankan government faces the challenge of repaying the foreign debt in the coming years.

