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SBP Governor explains Currency Swap Agreement with Peoples Bank of China

The Governor, State Bank of Pakistan, Mr. Yaseen Anwar today issued the following press statement to explain the Currency Swap Agreement with Peoples Bank of China:

‘On December 23, 2011, the undersigned signed a landmark Currency Swap Agreement (CSA) with the Peoples Bank of China (PBC) in Islamabad in the presence of the Prime Minister of Pakistan and the State Councilor of the Peoples Republic of China. This agreement represents a significant achievement for both governments in promoting and enhancing not only bilateral trade, but also the opportunity to significantly increase investment in Pakistan going forward.

Given the numerous questions or misconceptions one might have and the potential of not realizing the significant direct and indirect benefits of this landmark agreement, I would like to highlight the features of the CSA and its modus operandi.

The CSA has been executed for a tenor of 3 years in respective local currencies, Pakistan Rupee 140 Billion and Chinese Yuan 10 Billion. This is the second Currency Swap Arrangement that State Bank of Pakistan has signed, the first one being with the Central Bank of Turkey on November 1, 2011.

While these are strictly bilateral arrangements, the precise terms and conditions of each of these CSAs are confidential between the two Central Banks; however, a close scrutiny of the information available in the public domain indicates that the principal objective of these swaps is to promote the use of regional currencies for trade settlement purposes and specifically in the case of China, it is to enhance the role of the Chinese Yuan in international trade and investment. China’s concurrent Yuan local currency settlement program is also consistent with the underlying currency swap objectives. The latest CSA between Pakistan and China also reflects similar objectives of promoting trade and investment in bilateral currencies.

Objectives & Structure of CSA:

The objective of the swap is to 1) promote bilateral trade, 2) finance direct investment between the two countries in the respective local currencies of the two countries and 3) any other ‘purpose’ as mutually agreed between the two central banks.

Since the CSA is a bi-lateral financial transaction, all terms & conditions apply equally to both countries and the pricing is based on standard market benchmarks which are widely acceptable in the respective domestic markets of the two countries. The following are more details on the structure of the transaction:

1. Both Central Banks will have the ability to draw on the swap line any time during the tenor of the swap.
2. SBP can purchase CNY from PBC against its local currency (PKR), and repurchase its local currency with the same CNY on a predetermined maturity date and exchange rate. Similarly PBC can also purchase PKR against CNY. Standard market pricing will apply

on the date of utilization. Like any swap, the pricing is linked to interest rates differentials between the two currencies.

3. However, drawing under the swap line by either central bank will be contingent on 1) bi-lateral trade being denominated in local currencies, or 2) financing of direct investment between the two countries.

Swap utilization for financing Trade and Investment:

The announcement of the Currency Swap Agreement between the two Central Banks will give a positive signal to the market on the availability of liquidity of the other country's currency in the onshore market. This means that for example, SBP will have the ability to draw on the swap line and provide Chinese Yuan to banks in Pakistan. Banks will on-lend this liquidity to importers/ exporters involved in trade denominated in Yuan. At maturity, the importer/exporter will repay the foreign currency to the lending bank; and the bank will repay to the respective central bank. The trade financing regulations in foreign currencies are already available in Pakistan for providing liquidity and facilitating trade. The same concept will also apply in the case of PBC borrowing PKR for trade or investment in Pakistan.

Let me briefly detail the process: Utilization of CNY in Pakistan on account of CNY/PKR swap: SBP will lend CNY to banks which will on-lend to:

1. **Importers with letters of credit denominated in CNY:**
   On the maturity date of the letter of credit (LC), the importer will pay off the overseas supplier by borrowing in CNY. Assuming borrowing is for 6 months, the importer will save on the rupee cost and after six months the importer will buy CNY against PKR and pay off the CNY loan. Availability of onshore CNY financing will encourage importers to open CNY denominated LCs.

2. **Exporters with letters of credit / contracts denominated in CNY:**
   Once the contract is established, the exporter will borrow in CNY, sell CNY against PKR and utilize PKR for its local operations. On the maturity date of the contract, the exporter will receive CNY from the overseas buyer and payoff the CNY loan locally.

Utilization of PKR in China: Same concept will apply to PBC drawing PKR against the swap line and lending the same to banks in China. China has significant investments in various projects in Pakistan and Rupee proceeds of the swap can be channelized to such long-term projects in Pakistan via Chinese banks.

Concurrently with the arrival in Pakistan of the Industrial Commercial Bank of China (ICBC), the largest bank in China (and the world in terms of Capital), the CSA provides a strong boost towards building offshore investor confidence that will encourage other investors to capitalize on the economic opportunities in Pakistan.'

Yaseen Anwar
Governor
State Bank of Pakistan