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Central Banks' Currency Swaps in External Sector Statistics: Brazil Experience

Prepared by the Banco Central do Brasil

Central Banks' Currency Swaps in External Sector Statistics

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INTRODUCTION: DEFINITION AND OBJECTIVES

Currency swaps between central banks have been widely used since the great financial crisis. They initially played a key role in overcoming foreign currency shortages in the most difficult period of the crisis. Now, extensive networks of central banks' currency swap agreements are in place to support trade and investment and to serve as "insurance" against financial instability and shocks¹.

Probably the simplest definition of a standard currency swap can be referred to the *MFSMCG 2016*² paragraph 4.171 which states that "a foreign currency swap is a spot sale/purchase of currencies and a simultaneous forward purchase/sale of the same currencies"³. The paragraph 6.102 of the **BPM6 states the specificity of a currency swap among central banks, mainly noting that the deposits resulting from the foreign currency exchanged are classified as reserve assets** (if they meet all the necessary criteria). Besides that, **a characteristic of a central banks' currency swap transaction is the temporary exchange of deposits denominated in each central bank domestic currency.**

Among the objectives of such financial instruments are: meet balance of payments financing needs; address financial stability issues; provide liquidity (in foreign currency) to financial and non-financial corporations; and help restoring confidence in the affected economies.

In the following sections, this paper explains how a central banks' currency swap works; enumerate its types; and make a proposition on how to record them in external sector statistics' (ESS) reports such as Reserves Data Template, Balance of Payments (BoP) and International Investment Position (IIP).

HOW IT WORKS

The mere assignment of a central banks' currency swap agreement does not reflect any economic transaction and no records should be made in the ESS⁴. The total amount of a swap agreement is considered a contingent asset since it was not disbursed (*BPM6*, paragraph

¹ The Council on Foreign Relations publishes an interactive map showing the extent of the network formed by such agreements up to 2015 at https://www.cfr.org/interactives/central-bank-currency-swaps-since-financial-crisis?cid=otr-marketing_use-currency_swaps#!/central-bank-currency-swaps-since-financial-crisis?cid=otr-marketing_use-currency_swaps.

² *Monetary and Financial Statistics Manual Compilation Guide (MFSMCG 2016)*, prepublication draft.

³ A more complete definition of a foreign exchange swap is found in the *International Reserves and Foreign Currency Liquidity. Guidelines for a data template* (2013), paragraph 173.

⁴ The sole possibility is in section III of the Reserves Data Template, if this undrawn foreign currency is made available for the requesting central bank in the most unconditional way in the very moment of the contract signature, which is, to our knowledge, high unlikely.

5.10). Individual currency swap transactions among central banks should only be recorded when the amounts of principal are effectively exchanged.

According to the IMF paper “Recording of Central Bank Swap Arrangements in Macroeconomics Statistics”, the currency swap transactions between central banks should be preferably recorded as an exchange of deposits, with the obligation to unwind the operation at a fixed exchange rate on a specified date. The deposit of the central bank that requested the currency swap held with the counterpart central bank is a foreign asset of the requesting party and could be part of its international reserves if they meet the general criteria for being a reserve asset. A similar treatment would be applied to the deposits of the providing party.

TYPES

In a bilateral currency swap arrangement between central banks, when both trade their own domestic currencies solely, there could be three possible scenarios, depending on the classification of the currencies involved, in terms of its convertibility:

- a) convertible currency vs. convertible currency – in this case, both central banks will see a rise in its international reserves, provided that the assets exchanged meet all other reserves criteria;
- b) **convertible currency vs. nonconvertible currency – in this case, the central bank receiving the convertible currency will register an increase in its international reserves while the other one will see no change in this kind of financial asset;**
- c) nonconvertible currency vs. nonconvertible currency – international reserves of both central banks will not be affected.

It is clear that item “b” will be the common ground in a bilateral currency swap arrangement, for a non-freely convertible currency issuer seeking for a hard currency, to alleviate imbalances affecting its balance of payments and foreign currency needs.

HOW TO RECORD CENTRAL BANKS’ BILATERAL CURRENCY SWAPS IN RESERVES DATA TEMPLATE, BOP AND IIP

Focusing in the central banks’ swap arrangements, specifically in the case that the requesting central bank is in search of a convertible currency (item “b” of the above typology), the funds received by requesting party will be treated as reserve assets. The reciprocal deposits acquired by the partner central bank could not be included in reserves, since they are not denominated and settled in a convertible currency.

The registries in the BoP accounts should be the following, regarding Convertible Currency vs. Non-Convertible Currency Swaps⁵:

⁵ For types “a” and “c” refer to annexes I and II.

Requesting Central Bank*	Providing Central Bank
Balance of Payments	
When currencies are exchanged – for the received foreign currency	
Increase in Reserve Assets – deposits: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits 3.5.4.1.1 Claims on monetary authorities (+)	Increase in Foreign Currency Assets – deposits: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+) No entries in Reserve Assets are made, because the received currency is not freely convertible.
Increase in Foreign Currency Liabilities: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)	Increase in Domestic Currency Liabilities: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)
Interests (considering that accrual cycle matches with payment frequency)	
Increase in Primary Income Expenses – due to interests paid: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (-)	Increase in Primary Income Receipts – due to interests received: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (+)
Decrease in Reserve Assets – deposits, for interests paid in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (-)	Increase in Reserve Assets – deposits, for interests earned in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (+) If interest is paid using the providing central bank's own convertible currency, a reduction in the foreign currency liabilities should be made.
International Investment Position	
When the currency swap is disbursed (paid back)	
An increase (reduction) in: Asset: 5. Reserve Assets 5.4 Other Reserve Assets 5.4.1 Currency and Deposits 5.4.1.1 Claims on monetary authorities Liability: 4. Other investment 4.2 Currency and deposits 4.2.1 Central Banks 4.2.1.0.1 Short-term	An increase (reduction) in: Asset: 4. Other investment 4.2 Currency and deposits 4.2.1 Central Banks 4.2.1.0.1 Short-term Liability: 4. Other investment 4.2 Currency and deposits 4.2.1 Central Banks 4.2.1.0.1 Short-term

<p>In Reserve-Related Liabilities, Table A9-V. Memorandum/Supplementary Items: Position Data (at a reference date): 2. Reserve-Related Liabilities (RRL) to nonresidents 2.2 Short-term 2.2.3 Deposits</p>	
Reserves Template	
<p>Independently of the existence of any conditionality, when the Swap is disbursed (paid back):</p> <p>An increase (reduction) in:</p> <p>Section I.A Official reserve assets (1) Foreign currency reserves (in convertible foreign currencies) (b) Total currency and deposits with: (i) Other national central banks, BIS and IMF</p> <p>Section II Predetermined short-term net drains on foreign currency assets (nominal value) 1 Foreign currency loans, securities, and deposit outflows (-). Principal</p> <p>If the currency arrangement is <u>unconditional</u>, when the Swap is disbursed (paid back):</p> <p>Reduction (increase) in:</p> <p>Section III Contingent short-term net drains on foreign currency assets (nominal value) 3 Undrawn, unconditional credit lines provided by: (a) - other national monetary authorities (+)</p>	<p>No registries in the reserve template are made, because the received currency is not to be treated as a reserve asset.</p>

* Non-freely convertible currency issuer.

ANNEX I – Convertible Currency vs. Convertible Currency Swaps

Requesting Central Bank	Providing Central Bank
<u>Balance of Payments</u>	
When currencies are exchanged – for the received foreign currency	
Increase in Reserve Assets – deposits: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits 3.5.4.1.1 Claims on monetary authorities (+)	Increase in Reserve Assets – deposits: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits 3.5.4.1.1 Claims on monetary authorities (+)
Increase in Foreign Currency Liabilities – for the received currency: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)	Increase in Domestic Currency Liabilities – for the received currency: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)
Interests (considering that accrual cycle matches with payment frequency)	
Increase in Primary Income Expenses – due to interests paid: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (-)	Increase in Primary Income Receipts – due to interests received: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (+)
Decrease in Reserve Assets – deposits, for interests paid in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (-)	Increase in Reserve Assets – deposits, for interests earned in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (+)
<u>International Investment Position</u>	
When the currency swap is disbursed (paid back)	
An increase (reduction) in: Asset: 5. Reserve Assets 5.4 Other Reserve Assets 5.4.1 Currency and Deposits 5.4.1.1 Claims on monetary authorities Liability: 4. Other investment 4.2 Currency and deposits 4.2.1 Central Banks 4.2.1.0.1 Short-term	An increase (reduction) in: Asset: 5. Reserve Assets 5.4 Other Reserve Assets 5.4.1 Currency and Deposits 5.4.1.1 Claims on monetary authorities Liability: 4. Other investment 4.2 Currency and deposits 4.2.1 Central Banks 4.2.1.0.1 Short-term

<p>In Reserve-Related Liabilities, Table A9-V. Memorandum/Supplementary Items: Position Data (at a reference date): 2. Reserve-Related Liabilities (RRL) to nonresidents 2.2 Short-term 2.2.3 Deposits</p>	<p>In Reserve-Related Liabilities, Table A9-V. Memorandum/Supplementary Items: Position Data (at a reference date): 2. Reserve-Related Liabilities (RRL) to nonresidents 2.2 Short-term 2.2.3 Deposits</p>
Reserves Templates	
<p>Independently of the existence of any conditionality, when the Swap is disbursed (paid back):</p> <p>An increase (reduction) in:</p> <p>Section I.A Official reserve assets (1) Foreign currency reserves (in convertible foreign currencies) (b) Total currency and deposits with: (i) Other national central banks, BIS and IMF</p> <p>Section II Predetermined short-term net drains on foreign currency assets (nominal value) 1 Foreign currency loans, securities, and deposit outflows (-). Principal</p> <p>If the currency arrangement is <u>unconditional</u>, when the Swap is disbursed (paid back):</p> <p>Reduction (increase) in:</p> <p>Section III Contingent short-term net drains on foreign currency assets (nominal value) 3 Undrawn, unconditional credit lines provided by: (a) - other national monetary authorities (+)</p>	<p>Independently of the existence of any conditionality, when the Swap is disbursed (paid back):</p> <p>An increase (reduction) in:</p> <p>Section I.A Official reserve assets (1) Foreign currency reserves (in convertible foreign currencies) (b) Total currency and deposits with: (i) Other national central banks, BIS and IMF</p> <p>Section II Predetermined short-term net drains on foreign currency assets (nominal value) 1 Foreign currency loans, securities, and deposit outflows (-). Principal</p> <p>If the currency arrangement is <u>unconditional</u>, when the Swap is disbursed (paid back):</p> <p>Reduction (increase) in:</p> <p>Section III Contingent short-term net drains on foreign currency assets (nominal value) 3 Undrawn, unconditional credit lines provided by: (a) - other national monetary authorities (+)</p>

ANNEX II – Non-Convertible Currency vs. Non-Convertible Currency Swaps

Requesting Central Bank	Providing Central Bank
Balance of Payments	
When currencies are exchanged – for the received foreign currency	
Increase in Foreign Currency Assets – deposits: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+) No entries in Reserve Assets are made, because the received currency is not freely convertible.	Increase in Foreign Currency Assets – deposits: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+) No entries in Reserve Assets are made, because the received currency is not freely convertible.
Increase in Foreign Currency Liabilities – for the received currency: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)	Increase in Domestic Currency Liabilities – for the received currency: 3. Financial Account 3.4 Other investment 3.4.2 Currency and deposits 3.4.2.1 Central bank 3.4.2.1.1 Short-term (+)
Interests (considering that accrual cycle matches with payment frequency)	
Increase in Primary Income Expenses – due to interests paid: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (-)	Increase in Primary Income Receipts – due to interests received: 1.B Primary Income 1.B.2 Investment income 1.B.2.3 Other Investment 1.B.2.3.2 Interest (+)
Decrease in Reserve Assets – deposits, for interests paid in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (-)	Increase in Reserve Assets – deposits, for interests earned in convertible currency: 3. Financial Account 3.5 Reserve assets 3.5.4 Other reserve assets 3.5.4.1 Currency and deposits (+)
International Investment Position	
When the currency swap is disbursed (paid back)	
An increase (reduction) in: <ul style="list-style-type: none"> • Asset: Other investment, Currency and Deposits, Central banks, Short-term; • Liability: Other investment, Currency and deposits, Central banks, Short-term. 	An increase (reduction) in: <ul style="list-style-type: none"> • Asset: Other investment, Currency and Deposits, Central banks, Short-term; • Liability: Other investment, Currency and deposits, Central banks, Short-term.
Reserves Templates	
No registries in the template are made, because the received currency is not freely convertible.	No registries in the template are made, because the received currency is not freely convertible.