Case of Indo-Japanese Currency Swap

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ABSTRACT

The Indo Japanese currency swap in October 2018 happens to be one of the biggest currency Swaps betwixt the nations in Asia. It is certainly the largest in the economic history of India based on the nominal value. The swap meant that down the line within a time frame India can ask Japan for Japanese Yen or US dollar in exchange for rupee and Japan could do the same at the fixed rate decided. After time period decided in the contract the positions taken by the parties need to be squared off. The borrowers need to pay an interest rate that is based on LIBOR (London Interbank Operating Rates). The quantum of the "Swap" was disclosed to be 75billion USD (US dollars). Japan has been known to look out for destinations of investments as Demand for Money in the nation has been low for quite some time. To deal with low demand for money Japan had been on a spree of Swap agreements at that time.It had entered into similar contract with China for 30 billion USD. Japan also inked similar agreements with Malaysia, Thailand, and Singapore too. On the other hand, India at that time hand was facing serious devaluation of rupee triggered by Hike at Crude oil prices, and protectionist regimes of trade surfacing once again o the global trade scenario. There had been significant flight of capital since the devaluation. Stabilization of the Indian rupee had become a matter of importance to the Indian economy. This case explores the reasons why such an alternative was resorted to be the Reserve Bank of India, and what could have been the optimal pricing of the deal

Keywords: Derivative for Currency Risk, Hedging Currency Risk, Swap Valuation

1. INTRODUCTION

On the 31-Oct-2018 Rajesh, a teacher in Financial Risk Modeling at a Management institute was mulling the news about the currency Swap between India and Japan which was there in all the daily newspapers in India. This happens to be one of the biggest currency Swaps betwixt the nations in Asia. It is certainly the largest in the economic history of India. The swap meant that down the line within a time frame India can ask Japan for JapaneseYen or US dollar in exchange for rupee and Japan could do the same at the fixed rate decided. After time period decided in the contract the positions taken by the parties need to be squared off. The borrowers need to pay an interest rate that is based on LIBOR (London Interbank Operating Rates).Thequantum of the "Swap" was disclosed to be 75billion USD (US dollars).Off late Japan has been on a spree of

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