What are currency swap lines?

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A currency swap line is an agreement between two central banks to exchange currencies. This allows a central bank to obtain foreign currency liquidity from the central bank that issues it – usually because they need to provide this to domestic commercial banks. For example, the swap line with the US Federal Reserve System enables the ECB and all the national central banks in the euro area (Eurosystem) to receive US dollars from the Fed in exchange for an equivalent amount of euro provided to the Federal Reserve. These agreements have been part of central banks' set of monetary policy instruments for decades.

Why do we need swap lines?

While swap lines were initially used by central banks to fund certain market interventions, in recent years they have become an important tool for preserving financial stability and preventing market tension from affecting the real economy. The swap agreements established by the ECB since 2007, for instance, have been geared towards providing foreign currency liquidity to domestic banks. When funding markets in one currency deteriorate, it becomes difficult for banks outside that currency area to fund their assets tied to this currency since they have no direct access to the foreign central bank that issues the currency. But if their home central bank has a swap line with the foreign central bank, the home central bank can provide its banks with the required liquidity in the foreign currency without using its foreign reserves. During the financial crisis following the collapse of Lehman Brothers in September 2008, for example, funding markets dried up because of an extreme aversion to risk. Under these circumstances it became difficult for euro area banks to obtain US dollars to fund their USD-denominated assets. To prevent disruptions, such as banks having to sell assets abruptly and thus provoking extreme price movements, the ECB and the Federal Reserve set up a currency swap line, allowing the ECB/Eurosystem to provide US dollars to banks located in the euro area.

With which central banks does the ECB have currency swap agreements?

In 2011 the ECB, along with the Bank of England, the Bank of Canada, the Bank of Japan, the Federal Reserve and the Swiss National Bank, set up a network of swap lines enabling the participating central banks to obtain currency from each other. As of April 2020, these swap lines have been used to lend US dollars and Swiss francs to euro area banks as well as euros to UK banks.

In the aftermath of the financial crisis the ECB set up arrangements to provide euro to the central banks of Denmark and Sweden. The ECB also made temporary arrangements to provide euro to the central banks of Hungary and Poland, as well as to the central bank of Latvia before the country joined the euro area in 2014.

In 2013 the ECB established a currency swap agreement with China, reflecting the country's growing systemic importance and the rapid growth of trade and investment between China and the euro area. For the Eurosystem, the agreement serves as a liquidity backstop to reassure euro area banks that Chinese renminbi will continue to be available even if the market becomes impaired.

Since then we have established new temporary swap lines with a number of central banks across the world, and some swap lines have expired.

Overview of existing swap lines

How do the swap lines work?

Under normal circumstances a bank in the euro area turns to the market if it needs US dollars, for example to provide a US dollar loan to a client. But if US dollar funding costs are too high or if the market is disrupted, the bank can go to its national central bank. In this particular case the ECB can get dollars thanks to the currency agreement with the Federal Reserve. The ECB has been conducting regular US dollar providing operations since the global financial crisis, via which euro area banks can say how many dollars they want to borrow at a predefined interest rate. In return for the dollars, they must provide the ECB with high-quality collateral, the value of which is determined by current market prices ("mark to market") minus an appropriate deduction (referred to as a "haircut"). Many of these currency agreements act mainly as a safety net and have never been activated. In line with its general policy to ensure a high level of operational readiness, the ECB regularly tests its monetary policy instruments and tools to make sure that they can be easily and safely deployed if and when needed.

Update: This explainer was updated on 18 May 2022 to provide more details on the topic.

Central banking Monetary policy Financial stability