Currency Swaps: The $80 Trillion Time Bomb
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According to the Bank for International Settlements, there is an $80 trillion ticking time bomb contained in off-balance sheet dollar-denominated debt in foreign exchange swaps.

Foreign exchange derivatives are masking huge debts of banks and other financial firms, posing a serious problem for regulators, according to an analysis published by the Bank for International Settlements.

Embedded in the foreign exchange derivatives market is a huge, invisible dollar debt, warn authors Claudio Borio, Robert McCauley, and Patrick McGuire.

Hidden Debt

By allowing companies to borrow dollars in exchange for another currency, currency derivatives
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resemble repos, creating a potential stress point. The estimated hidden debt of more than $80 trillion exceeds holdings of dollar Treasury bills, repurchase agreements, and commercial paper combined, according to BIS data.

It has grown from just over $55 trillion a decade ago, while foreign exchange swap turnover was nearly $5 trillion a day in April, accounting for two-thirds of daily global foreign exchange turnover.

This off-balance-sheet dollar debt poses a particular challenge for policymakers because it is not captured in standard debt statistics, the «central bank for central banks» warns.

Twice as High

For both non-US banks and other non-US financial institutions, such as pension funds, dollar obligations from currency swaps are now twice as high as their on-balance sheet dollar debt, the BIS cautions. For banks domiciled outside the United States, debt from these instruments is estimated at $39 trillion.

Currency swap markets are vulnerable to funding shortages as was evident during the 2008-09 financial crisis and again in March 2020, when the Covid 19 pandemic wreaked havoc, according to the BIS.

Swaps as Flashpoints

Despite the the differences between 2008 and 2020, swaps proved to be flashpoints in both episodes, as dollar borrowers had to pay high interest rates to borrow at all. To restore market functioning, central banks channeled dollars through swap lines to non-U.S. banks abroad, which lent them on to those seeking dollars.