Last Thursday, an unidentified government official was reported in some local newspapers as saying that a CNY20 billion (USD2.9 billion) bilateral aid agreement with China has been concluded, which will include a deposit and a Yuan currency swap. While he did not elaborate further on the magnitude of the Yuan currency swap, we take this opportunity to explain the benefits and risks related to utilising the Yuan-denominated currency swap.

## How does the currency swap work?

At inception of the currency swap, the People's Bank of China (PBOC) will provide the Central Bank of Egypt (CBE) with a certain amount of Yuan in return for an EGP equivalent amount, using the CNY/USD and EGP/USD exchange rates. Then, the CBE will be able to offer the local Egyptian banks with Yuan in order to settle import transactions from China. During the term of the swap, both counterparties exchange fixed or floating interest payments on the principal amounts. At swap maturity, the CBE will repay the initial Yuan-denominated amount, and receive the initial EGP lump sum.

## Limitations to a Yuan swap

In that context, we note there are two main limitations on the use of the aforementioned Yuan swap: (1) It cannot be used to repay USD-denominated debt, and (2) It cannot be used to import goods or services from another country except for China.

## Mutual benefits

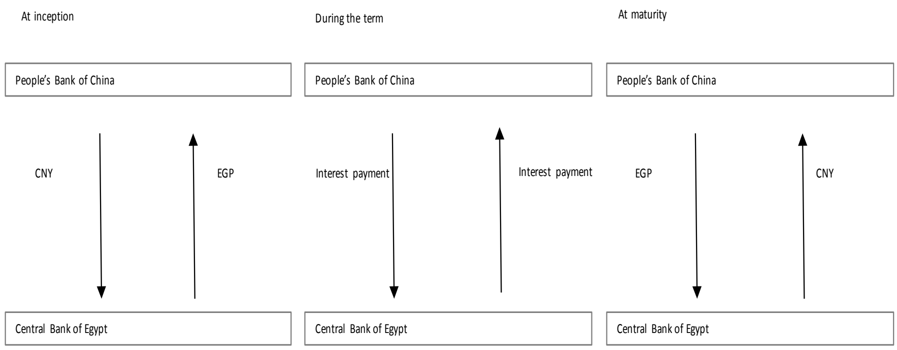
For China, providing trading partners with Yuan currency swaps has been another move on the road to expand, albeit gradually, the use of the Renminbi on the international arena. For Egypt, it marks an opportunity to support the CBE's FCY reserves whilst slightly ease local demand for the USD. We note that China is a major trade partner with Egypt representing c.7% of Egypt's total foreign trade in FY2015/16. Egyptian imports from China recorded USD5.2 billion in FY2015/16 (c.8% of total imports in FY2015/16).

## Minimal risk of Yuan devaluation versus the Dollar

We note that the CBE reports its net international reserves (NIR) in USD. Hence, holding part of the NIR in Yuan can impact the value of NIR in case of Yuan devaluation versus the USD. However, this should not be much of a concern, as the Yuan-denominated portion of NIR is small. The same risk applies on the CNY/USD exchange rate difference at the time of swap maturity versus that at the time of swap inception.

**To sum it up, we believe that acquiring a Yuan currency swap provides the CBE with an extra tool to stabilise the current high USD demand, in addition to more FX liquidity at a reasonable cost.**

Figure 1 l Currency Swap Mechanism




Source: Pharos Research

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