

Hope of US trade deal fuels ₹ gains

ANJALI KUMARI

Mumbai, 3 July

The rupee strengthened sharply on Wednesday, rising to a high of 85.19 against the US dollar, as hopes grew that India and the US could finalise a trade deal in the next 48 hours, said dealers.

The rally started early in the day with foreign banks selling dollars, as many traders were already betting on a stronger rupee. However, state-owned banks bought dollars on the behalf of the Reserve Bank of India after the initial gains which capped gains. The rupee settled at 85.32 per dollar, against the previous close of 85.71 per dollar.

Market participants said that once the rupee breached 85.45 per dollar mark, stop-losses were triggered, pushing the currency even higher. Foreign portfolio investors (FPIs) were also buyers, adding to the rupee's gains, they said.

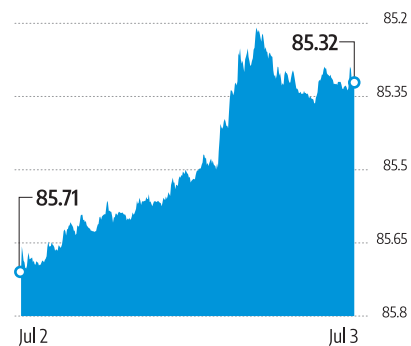
"RBI may have stepped in to buy dollars, which pulled the rupee back. The market remained heavily tilted in favour of the rupee, supported by trade deal hopes and falling crude oil prices," said a market participant.

US President Donald Trump has announced a trade agreement with Vietnam that reduces US tariffs on several Vietnamese goods to 20 per cent, down from the previously proposed 46 per cent. The development has raised hopes that other countries, including India, may also be able to secure trade deals with Washington ahead of the July 9 deadline, when Trump's 90-day pause on "reciprocal tariffs" is set to expire. The dollar index fell to 96.82 in Asian trade, against 97.05 on Wednesday. It



Gaining ground

₹ vs \$ spot (inverted scale)



Source: Bloomberg

measures the strength of the greenback against a basket of six major currencies. Additionally, Brent crude prices fell to around \$68.50 per barrel from above \$69 per bbl to, reversing the 3 per cent gains seen overnight.

In the past few days, the rupee was stuck in a range of 85.40 per dollar to 86.00 per dollar. With the recent gains, it has now moved to 85.31. Going forward, 85.50 is expected to act as a strong resistance level, said market participants.

Banking system liquidity hits 3-yr high at \$3.74 trn

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Banking system liquidity rose further to a net surplus of ₹3.74 trillion, highest since June 1, 2022, latest data by the Reserve Bank of India (RBI) showed.

The recent improvement in banking system liquidity can largely be attributed to higher government spending and lower-than-expected goods and services tax (GST) collections, which have eased the usual liquidity pressures. As a result, the liquidity drain was not as sharp as anticipated, dealers said, adding that with RBI already having reduced the Cash Reserve Ratio (CRR), its room for deploying other measures for liquidity withdrawal apart from variable rate reverse repo (VRRR) auction is limited.

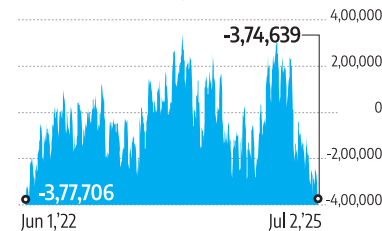
Further, they said RBI is expected to stick to shorter-tenure VRRR operations so that durable liquidity is not impacted as the regulator is aiming at improving monetary transmission following 100 bps repo rate cut in quick succession.

Banks are also unlikely to participate in longer-term VRRRs, as they prefer maintaining flexibility amid fluctuating cash requirements. This makes long-duration liquidity absorption tools less practical in the current environment.

"The main reason behind the liquid-

Cash injection

RBI net liquidity injected (₹ cr)



Note: (-) indicates liquidity absorption
Source: RBI, Bloomberg

ity improvement is government expenditure and less GST collections, so the drain of liquidity was not as much as expected. Given that the RBI has cut CRR, they can't deploy any other measure right now apart from VRRR. They will go with shorter tenure VRRR as to not overlap with GST outflows. And banks would not want to park their funds for a longer period, so long term VRRR is also not feasible," said Indranil Pan, chief economist at YES Bank.

The surplus liquidity has kept the overnight weighted average call rate near the Standing Deposit Facility (SDF) rate of 5.25 per cent and below the repo rate of 5.50 per cent.